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WITNESSES

HOME EQUITY LOAN CONSUMER PROTECTION ACT OF 1987 (H.R. 3011)

Tuesday, October 6, 1987

House of Representatives,
Subcommittee on Consumer Affairs and Coinage,
Committee on Banking, Finance, and Urban Affairs,
Washington, DC.

The subcommittee met pursuant to call at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Frank Annunzio, [chairman of the subcommittee] presiding.

Present: Chairman Annunzio, Representatives Wylie, Pelosi, and Hiler.

Chairman Annunzio. This morning the subcommittee meets to consider legislation establishing additional consumer safeguards for home equity loans.

Home equity loans may well be the fastest growing craze since the hoola hoop. But unlike the hoola hoop, which cost about $1.98 and normally ended up in yard sales after a few months use, home equity loans are not a nickel and dime proposition. In 1981, only slightly more than $20 billion was loaned on home equity loans. By 1986, that figure had increased 500 percent, with more than $100 billion being loaned on the equity built up in a person's home. The figures for 1987 are still not available, but home equity loans could well reach the $200 billion origination mark for this year. These loans are growing so rapidly that it is very difficult to obtain accurate figures as to the volume of outstanding loans.

But by all estimates, even the large amount of money outstanding in home equity loans is only a microscopic dot compared to the amount of equity that American homeowners have built up in their homes.

It is difficult for me to envision any dollar amount greater than the national debt of the United States, which is currently over $2 trillion. But it is estimated that homeowners in this country have equity values in their homes of $4.83 trillion, more than twice the amount of the national debt. It is further estimated that nearly 97 percent of the home equities built up by homeowners are still available for borrowing. So while the interest in home equity loans has risen faster than a new Bruce Springsteen record, there is still so much untapped home equity potential, $4.83 trillion worth, that if all of those dollars were placed in a stack, it would reach 32,000 miles in the air and would weigh 490 million tons.

In short, in considering the home equity situation, we certainly can say that the best or worst is yet to come. That is why today we

are hearing testimony on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987, introduced by Congressman David Price of North Carolina, a distinguished Member of the Committee on Banking, Finance and Urban Affairs.

I commend Congressman Price for his insight in being the first Member of Congress in either the House or the Senate to introduce a bill to provide a legislative cage for the home equity tiger. Congressman Price has established a starting point on which to build the necessary consumer protection legislation for home equity loans. He will forever be remembered as the Member of Congress who was first to act in this important field.

There can be no doubt that consumers view home equity loans as an important choice in considering loan options, particularly since Congress removed the tax deductibility of other consumer loans while leaving the deductibility intact for home equity loans. But while home equity loans may provide a homeowner with a new car, a dream vacation or a way to pay college costs, home equity loans could also do more damage to American homes than termites. The bottom line of all home equity loans is that if the loan is not repaid the homeowner may very well lose his or her home.

I am not here today to play Chicken Little. I do want consumers, however, to realize that the risks of home equity loans are so great that a detailed examination of many factors must be considered before entering into a home equity loan. Others will discuss the disclosure, contractual and advertising pitfalls of the home equity loans. I am going to limit my opening comments to the dollar and cents problem.

A large percentage of home equity loans do not have a fixed interest rate but rather are written with a variable rate index. For the most part the index used for the variable rate is the prime rate. Variable home equity loans carry an interest rate that ranges from 1½ to 4 percent over prime. Those words mean little, but the numbers are very, very important. At the present time the prime rate is 8¾ percent. If a homeowner obtained a $50,000 15-year home equity loan at 2 percentage points above today's prime, that loan would carry an interest rate of 10¾ percent. The monthly payments on that loan would be $560.70.

Certainly no homeowner would take out a loan without determining the monthly payment would fit into the family budget. But remember that payment is not fixed and will change periodically. For example, if the prime rate increased just 2 percent, the monthly figure would increase to $624.72, an increase of $64.02 per month which most families with some scrimping and saving could probably handle.

But let's move to the dream world where the prime rate is now 21 percent and the rate on that same home equity loan is 23 percent. The monthly payment now jumps to $991.88, an increase of $431.17 over the monthly payment at the start of the loan. How many American families could absorb an increase that is nearly double the original monthly payment?

And is that really a dream world situation? In 1980, less than 7 years ago, the prime rate hit 21 percent, and remember our mythical home equity loan has a 15-year maturity or a decade-and-a-half for prime rate skyrocketing.

The question that I would like every witness to address today is this. What will happen to a person's home who has a home equity loan and the prime rate starts heading for record numbers again? To the lenders I ask, how will you handle this situation? Will you foreclose on thousands of these loans? And what will that do to the real estate prices around the country? Are you prepared to absorb the losses that will occur when the value of these houses will not be enough to pay off the loan in a depressed real estate market? And to consumers, I ask what will be your course of action when you cannot pay the loan and you are faced with the threat of losing your home? Will you demand from Congress legislation to prevent the lender from foreclosing on your home? And is it realistic to expect that Congress will enact such a law?

I would like to do some contingency planning during these hearings so that both the borrower and the lender know what is expected of them if interest rates suddenly rise. If we can accomplish that one aspect of the broad question of home equity loans before the conclusion of these hearings, I think we all together will have done an outstanding job.

[The following was submitted for inclusion in the record at this point: The text of H.R. 3011.]

I

100TH CONGRESS
1ST SESSION

H. R. 3011

To amend the Truth in Lending Act to establish additional disclosure and advertising requirements for home equity loans.

IN THE HOUSE OF REPRESENTATIVES

JULY 23, 1987

Mr. PRICE of North Carolina (for himself, Mr. ST GERMAIN, Mr. WYLIE, Mr. ANNUNZIO, Mr. BARNARD, Mr. BEREUTER, Mr. BUSTAMANTE, Mr. COOPER, Mr. ECKART, Mr. FLAKE, Mr. FOGLIETTA, Mr. GARCIA, Mr. HAWKINS, Ms. KAPTUR, Mr. KENNEDY, Mr. KLECZKA, Mr. LAFALCE, Mr. MANTON, Mr. MORRISON of Connecticut, Mr. MURPHY, Mr. NEAL, Mrs. PATTERSON, Mr. SOLARZ, and Mr. VALENTINE) introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

To amend the Truth in Lending Act to establish additional disclosure and advertising requirements for home equity loans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Home Equity Loan Consumer Protection Act of 1987".

SEC. 2. ADDITIONAL DISCLOSURE AND ADVERTISING REQUIREMENTS FOR HOME EQUITY LOANS.

(a) DISCLOSURE REQUIREMENTS.—Section 127 of the Truth in Lending Act (15 U.S.C. 1637) is amended by adding at the end thereof the following new subsection:

"(c) ADDITIONAL REQUIREMENTS FOR OPEN END CREDIT PLANS SECURED BY THE CONSUMER'S DWELLING.—In addition to the disclosures required by section 127(a). In the case of any open end consumer credit plan secured by a consumer's dwelling the following provisions shall apply:

"(1) The disclosures required by paragraphs (3) and (4) of this subsection shall be given with the disclosures required by section 127(a), to the extent not duplicative as determined by the Board and, at the time of application or, in the case of telephone or mail applications, no later than 3 business days following receipt by the creditor of an application.

"(2) The disclosures required by paragraph (3) of this subsection shall be conspicuously segregated from all other terms, data, or information provided in connection with the plan.

"(3) The following information shall be disclosed:

"(A) The annual percentage rate which will be in effect when credit is first extended in con-

nection with such loan or a description of the manner in which such rate will be computed.

"(B) The manner in which any changes in the annual percentage rate of interest will be made, and the timing of any such changes, including any index or other rate of interest to which such changes in rates are related.

"(C) Any fee imposed for the availability of the account, including but not limited to, annual fees, application fees and the fees commonly designated as 'points'.

"(D) In the case of a variable rate, the maximum amount by which the annual percentage rate may change in any 1-year period. If no limit exists, that fact shall be disclosed.

"(E) In the case of a variable rate, the maximum annual percentage rate that may be imposed at any time under the plan. If no maximum limit exists, that fact shall be disclosed.

"(F) An example, based on a $10,000 amount outstanding, showing the periodic payment requirement under the terms of the plan. Such example shall also disclose the annual percentage rates that were or would have been in effect under the plan at calendar year-end during

the immediately preceding two years and their effect on periodic payments under the plan stated as a dollar amount in accordance with regulations promulgated by the Board: *Provided, however,* That where a plan contains no limits on annual and lifetime changes in the annual percentage rate as are required to be disclosed under subparagraphs (i) and (ii), the Board shall prescribe an example based on a three percentage point annual limit and eight percentage point lifetime limit on annual percentage rate changes.

"(G) A statement that the plan is secured by the consumer's dwelling and, in the event of any default, the consumer risks the loss of the home.

"(H) If applicable, a statement that the disclosures are good faith estimates of the terms and conditions applicable to the plan, and are subject to change before the plan is opened.

"(I) If applicable, a statement that the creditor has the right to change the terms and conditions during the plan, including the index and margin used to determine the interest rate and payment amount, at any time.

"(J) If applicable, a statement that although interest-only payments may be less on a monthly

basis, they retire no principal, prolong the obligation and result in greater total expense over the life of the loan.

"(4) The creditor shall supply a pamphlet published by the Board describing open end credit plans secured by the consumer's dwelling, or any pamphlet that the Board determines to be substantially similar.".

(b) FORM OF DISCLOSURE.—Section 122(b) of the Truth in Lending Act (15 U.S.C. 1632) is amended by striking out "section 128(b)(1)" and inserting in lieu thereof "sections 127(c)(2) and 128(b)(1)".

(c) ADVERTISING REQUIREMENTS.—Chapter 3 of the Truth in Lending Act (15 U.S.C. 1661 et seq.) is amended by adding at the end thereof the following new section:

"§ 147. Advertising of open end credit plans secured by the consumer's dwelling

"(a) IN GENERAL.—In addition to the requirements under section 143, any advertisement to aid, promote, or assist, directly or indirectly, the extension of consumer credit through an open end credit plan secured by the consumer's dwelling that states any specific terms of the plan including, but not limited to, any periodic payment amount shall state all of the following terms:

"(1) Any minimum or fixed amount which could be imposed.

"(2) In any case in which periodic rates may be used to compute the finance charge, the periodic rates expressed as annual percentage rates.

"(3) Any other term that the Board may by regulation require to be disclosed.

"(b) TAX DEDUCTIBILITY.—If any advertisement described in subsection (a) contains a statement that any interest expense incurred with respect to a plan is or may be tax-deductible, the advertisement shall include a clear and conspicuous statement that such interest expense may not be completely deductible for all taxpayers.

"(c) CERTAIN TERMS PROHIBITED.—No advertisement described in subsection (a) with respect to any home equity loan may refer to such loan as 'free money' or as a 'loan at prime'.".

(c) CLERICAL AMENDMENTS.—The table of sections for chapter 3 of the Truth in Lending Act is amended by inserting after the item relating to section 146 the following new item:

"147. Advertising of open end credit plans secured by the consumer's dwelling.".

(d) REGULATIONS.—Before the end of the 180-day period beginning on the date of the enactment of this Act, the Board of Governors of the Federal Reserve System shall prescribe such regulations as may be necessary to carry out the purposes of the amendments made by this section.

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect at the end of the 180-day period beginning on the date of the enactment of this Act.

SEC. 3. CONSUMER EDUCATION.

(a) CONSUMER PAMPHLET.—The Board of Governors of the Federal Reserve System shall develop and prepare a pamphlet for distribution to consumers which contains—

(1) a general description of open end credit plans secured by the consumer's dwelling and the terms and conditions on which such loans are generally extended; and

(2) a discussion of the potential advantages and disadvantages of such plans.

(b) AVAILABILITY AND DISTRIBUTION.—The Board of Governors of the Federal Reserve System shall make the pamphlets required to be prepared under subsection (a) available to banks, thrift institutions, other financial institutions, and such other public or private organizations as the Board may determine to be appropriate for the distribution of such pamphlets to the public. The Board may charge a reasonable fee for such pamphlets to cover any costs incurred in producing or distributing the pamphlet.

O

I want to ask our ranking minority Member of our full Banking and Currency Committee, Mr. Wylie, do you have a statement?

Mr. WYLIE. I have a brief opening statement. Thank you very much, Mr. Chairman.

I would like to compliment you for holding this hearing on a topic that has become increasingly important for a growing number of consumers, home equity loans. It has been reported as you mentioned some of these statistics, but they bear repeating. In 1986 consumers borrowed $175 billion in second mortgages and $35 billion of that was in the relatively new form of home equity loans. No doubt tax reform which phases out the deductibility for interest on most forms of consumer credit is the impetus for this explosion in home equity loans. Given the increasing importance of home equity loans, regulatory or statutory initiatives may be needed to insure that homeowners are given the information necessary to fully understand and appreciate the consequences of entering into such transactions.

While I do not believe that overly-restrictive legislation is needed, I believe that Mr. Price's bill provides a useful way of focusing the debate. I am pleased to say that I join Mr. Price as an original cosponsor of H.R. 3011.

We have some very important witnesses before us today, Mr. Chairman, and we want to hear from them. So I won't elucidate further on the issues now. Thank you very much.

Chairman ANNUNZIO. Thank you, Mr. Wylie. Our newest Member of the subcommittee from California, Ms. Nancy Pelosi, would you like to say something?

Ms. PELOSI. Thank you, Mr. Chairman. I, too, want to thank you for holding the hearings on this legislation of which I am also a cosponsor. I would like to ask unanimous consent for my statement to be read into the record.

Chairman ANNUNZIO. Without objection, your statement will be made part of the record this morning.

[The prepared statement of Ms. Pelosi can be found in the appendix.]

Chairman ANNUNZIO. This morning we have two panels. Our first panel consists of the Honorable David E. Price, United States Representative from North Carolina; the Honorable Charles E. Schumer, United States Representative from New York; and the Honorable Martha R. Seger, Member of the Board of Governors of the Federal Reserve System.

I want to extend this morning a warm welcome to my colleague, the Honorable David Price, from the fourth district of North Carolina. The fourth district includes the capitol city of Raleigh, a regional center of banking and high technology. He is a graduate of the University of North Carolina and Yale University.

He was a professor of political science in public policy at Duke University prior to his election to the House last year. He is one of the most active freshman on the Banking Committee. Mr. Price, I am going to allow you 10 minutes to present your testimony in your own manner, but your entire statement will be made part of the record.

Without objection, Mr. Price's statement will be part of the record.

STATEMENT OF HON. DAVID E. PRICE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. PRICE. Thank you, Mr. Chairman.

Chairman Annunzio, and Members of the subcommittee, I appreciate the opportunity to appear before you today, and I am grateful to you for scheduling hearings so promptly on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987.

Home Equity loans have become the latest financial craze. Much of the increasing popularity of these loans is due to the Tax Reform Act of 1986 which phased out the deductibility of interest on other consumer loans while leaving it in place for loans secured by one's home.

Banks have marketed this product heavily, and I have brought four examples of these advertisements with me here today. As you can see, each of these ads prominently displays one feature of these loans: a low interest rate, a discount on settlement fees, no closing costs, or fixed monthly payments. So these ads represent a dazzling array of appeals. The consumer is faced with various possible loan terms and conditions, which are often incomplete and sometimes misleading.

Unfortunately, under current law, that consumer may never be advised about the essential features of his or her home equity loan until it is time to sign the final agreement. Currently, under Regulation Z, a comprehensive set of disclosures is only provided when credit is actually extended to the borrower.

While these disclosures are necessary, they fail to give consumers key information at a time when it would be useful for comparing products at different institutions. Furthermore, a consumer may have already paid a nonrefundable fee and never seen important provisions of the loan.

H.R. 3011 will help the consumer place these loan options in perspective. Regardless of what first interested a consumer in home equity loans, H.R. 3011 will require that at the time of application a consumer will be given a series of key disclosures that will enable him or her to make a sound judgment about these loans, help him decide whether the loan is the best financial option for him compared to other options, and help him compare the home equity products offered by various institutions.

H.R. 3011 will ensure that disclosures about the interest rate and fees are given to consumers at an early date. The bill also requires a financial institution to disclose whether its loan product has annual and lifetime caps on interest rates, and to present an example which will let consumers see the potential impact of a rise in interest rates on their monthly payments.

These early disclosures will also include a series of statements about features of the loans, like interest-only payments, which may have drawbacks for some consumers. Finally, the Federal Reserve will be required to develop a pamphlet which will give detailed information about home equity loans and discuss their relative advantages and disadvantages.

My concern with the timing of the disclosures is consistent with the Federal Reserve Board's proposed changes to Regulation Z (Truth in Lending) regarding closed-end adjustable rate mortgages.

The most significant change to Regulation Z would be the requirement that more information be given consumers about adjustable rate mortgages at the time of application.

I believe there are good reasons to develop parallel requirements for home equity loans. Basically home equity loans are second mortgages. They are different in that they offer an open line of credit whereas most traditional mortgages are closed-end, but the differences should not obscure the necessity, in both cases, of informing consumers early on about the risk to their homes and the terms and conditions of the loan. This emphasis on early and complete disclosure of loan conditions is the essence of H.R. 3011.

H.R. 3011 also recognizes there have been some problems in the advertising of home equity loans, and I have included some provisions to remedy them. For example, the ad from American Security Bank features a monthly payment amount, but under Regulation Z this ad would not currently be required to reveal terms of the loan like the annual percentage rate. The APR, incidentally, is incompletely disclosed in the fine print of this particular ad. My bill will ensure that any periodic payment amount mentioned in an ad is accompanied by a full disclosure of terms by the lender.

The bill also outlaws misleading terms like free money which some consumer groups have pointed to as being used in ads. And it requires any advertisement which mentions the tax deductibility feature of these loans to clearly and conspicuously state that such interest expense may not be completely deductible for all taxpayers.

In formulating this bill, Mr. Chairman, I have discussed and considered proposals from both consumer and industry groups. This legislation has grown out of these discussions, and the result is a bill stronger for the consumer and more workable for financial institutions. I look forward to working with subcommittee Members as they proceed with further consideration of the bill.

I do, however, want to take this opportunity to discuss one area where I believe no change should take place. I am opposed to any change which would mandate restrictive requirements like a specific annual or lifetime cap on these loans.

I also believe with regard to caps on home equity loans, that Congress has recently expressed its view. The Competitive Equality Act of 1987 requires a creditor to establish a lifetime cap of their choosing on the interest rate of a home equity loan.

But most importantly, I am concerned about the impact of a cap on other customers of the bank, particularly low and moderate income consumers. Home equity loans are mainly a middle class and upper class phenomena. Data from the Survey Research Center have shown that home equity borrowers have a higher median income and education than homeowners generally.

If home equity loans were capped as "protection" for middle- and upper-income borrowers, institutions could be forced to shift costs to other customers, many of them lower-income borrowers who need a car loan or similar financial assistance.

Variable rate loans represent a contract between the bank and the customer. The customer receives lower rates than on a comparable fixed rate loan in exchange for taking on the risk of possibly higher rates in the future. My bill is designed to ensure that a con-

sumer is fully informed about the risks and benefits of these loans, but it will not encourage cost-shifting by restricting home equity loans more than other loan instruments.

I favor a good, strong disclosure bill because it will help the home equity borrower without harming the other customers of the bank.

Finally, I believe there is ample proof that our colleagues on the Banking Committee and throughout the House agree with the approach embodied in H.R. 3011. Currently, we have 52 cosponsors of this legislation, including 24 other Members of the Banking Committee. It is a bipartisan group of sponsors, I'm proud to say, and with the help of this subcommittee, we have a real chance to move quickly and put in place a disclosure bill of real benefit to the consumer.

I am grateful for this support. I am grateful for the cooperation of Members on both sides of the aisle and for this subcommittee's help. I look forward to continuing to work on this legislation with you. I appreciate the chance to appear here today and would later be happy to respond to any questions that you may have.

[The prepared statement of Mr. Price can be found in the appendix.]

Chairman ANNUNZIO. Thank you, Congressman Price, for your excellent presentation. This morning I am pleased to welcome my distinguished colleague, Charles Schumer of Brooklyn, New York, before the subcommittee.

Mr. Schumer served 7 years in the New York State assembly before being elected to Congress at the ripe old age of 29.

Now in his fourth term, he has been a very, very active Member of the House Banking Committee during his tenure on the committee, and he still continues to be a very active Member of our full committee.

He has testified before this subcommittee previously on consumer credit legislation. Mr. Schumer, it is my pleasure to have you before this subcommittee once again, and we look forward to your testimony. You have 10 minutes to summarize your statement, but your entire statement will be made part of the record.

Without objection, your statement is made part of the record. You can carry on.

STATEMENT OF HON. CHARLES E. SCHUMER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. SCHUMER. Thank you very much, Mr. Chairman. I first want to begin by thanking you for holding this important hearing on home equity loans and for inviting me to testify. As usual, Mr. Chairman, you are at the forefront of consumer banking issues.

I also want to thank Congressman Price for his leadership on this issue. Mr. Price has shown in a short time to be a great ally of consumers in his Banking Committee duties. He has come up with a good bill to solve a real problem, and it has been a pleasure working with him and will continue to be a pleasure working with him on this issue.

Mr. Chairman, at a time when consumer debt has risen to record levels, we are seeing yet another hot banking product that could

put many consumers over the brink. This new product is called the home equity loan. Banks have been pushing them with advertising dollars and consumers are lining up to apply for them. But home equity loans have several pitfalls if a consumer is not completely aware what he or she is buying. That is why these hearings are so important and that is why Congressman Price's legislation is so important.

The biggest problem is something that I would call "rate rise surprise." Too few consumers are aware that many home equity loans have a variable rate of interest that has no ceiling. Most of these loans carry an interest rate that is tied to an index. The problem is that the index is often very high. Even worse is that some banks use an index that is in control of the bank's board of directors and not necessarily based on the true cost of money.

Some home equity loans could start out for a few months at 5 percent, and then jump up to 25 or 30 percent, barring changes in State usury laws, and just put the purchaser of a home equity loan in an awful position, a position that could likely force him to forfeit his or her home.

For instance, Barclay's Bank of New York offers a home equity loan that has a variable rate, but no publicly available index. The index is determined as mentioned, by the board of the bank. The interest rate can potentially rise out of sight even if the cost of money has not increased.

The problem of "rate rise surprise" is made even worse by the advertisement of super low teaser rates that only apply for the first few months of the loan. And so I think that legislation is most definitely needed to alert consumers to these kinds of pitfalls.

Another potential pitfall of the home equity loan is what I call balloon crunch. Many banks offer temptingly low interest rates and payment schedules at the beginning of the loan only to slam the consumer with one lump payment in later years.

American Security Bank of Washington and Manufacturer's Hanover of New York offer home equity loans that allow for interest-only payments on the loans for the first 10, not months, but years of the loan. After 10 years, the entire amount of the loan is due in one lump sum payment. The consumer can go into that loan not being aware that forfeiture of the home is a possibility.

In a particularly bad case, Mr. Chairman, the Bank of Contra Costa in San Francisco offers a home equity loan that allows the consumer to pay only 1.5 percent of the balance for 5 years and then requires a balloon payment of the entire amount of the loan. And the minimum line they extend is $25,000. So the final payment could sink many, many, families.

Perhaps the most troubling trend in the marketing of home equity loans is that the consumer is rarely given the whole picture in advertisements and solicitations for the product, as my colleagues have pointed out.

Although many ads for home equity loans tout the supposed tax deductibility of the loans and scream about the loans being free money, there are often key facts that the banks don't advertise. Citizens Savings Banks in Washington has run ads that go to great lengths to advertise its interest rate is fixed for 3 years. What the

ad does not say is that after 15 years the loan results in a balloon payment.

The Bank of the West in California loves to advertise the great things a home equity loan can provide money for, but it makes no mention of its interest rate, its index or its big balloon payment.

Congressman Price's legislation goes a long way toward dealing with these major problems I've outlined. It clarifies that home equity loans are subject to the same disclosure requirements under the Truth in Lending Act that other mortgage instruments are.

The Price legislation takes the important step to ensure that the rate of interest and how that rate is calculated or adjusted in the future are all clearly disclosed to the consumer at the time of application.

The Price bill also mandates that certain warnings be given to the consumer before they take out the loan. These warnings are about the danger of interest only payments, potential home loss and the potential interest rate increase, all necessary to give borrowers the whole story before they borrow.

There are, however, areas of consumer protection where I would go further than Congressman Price. I agree with Mr. Price, that the main thrust of any home equity loan legislation should be disclosure. In addition to the strong provisions already contained in the bill, I feel it is important to disclose the index, the timing and the nature of future rate changes, any annual fees and other payment terms in advertisements for the loan.

I would also require that the possibility of a huge balloon payment be disclosed. Clear disclosure of these items in ads will allow potential borrowers to comparison shop much easier. It will also put a chill on the many deceptive ads we have seen.

I would also make it illegal for any bank to be in control of the index that will be used to calculate the changes in the interest rate. If interest rate on a home equity loan is going to be variable, then it should be a publicly available index, not some arbitrary number that is changed at the whim of the bank. And to further protect the borrower, I would make interest-only payments on home equity loans illegal.

Interest only payments, ones that retire no principal, have the advantage of allowing for low monthly payments. The problem is that if a percentage of the principal is not paid off as the loan matures, the payments in the closing years can be devastating and a family can lose their home.

I would also add a provision that would outlaw what I call surprise balloon payments. Surprise balloon payments occur when a lender decides that they want to close out a home equity loan, without prior warning. Often lenders reserve this right in the contract. Also, as I mentioned above, the possibility of a balloon payment should be clearly outlined in advertisement, application as well as the contract. I would also make it illegal to call in the loan before it has matured, unless the borrower has been delinquent.

Finally, I would like to see an annual cap on the amount of the interest rate that a home equity loan may increase. An annual cap of 2 percent, the amount used by Fannie Mae in variable rate mortgages. That would mean that if interest rates went at a high percent, up at a high percentage, 5 or 6 percent a year, it would

take 3 years to get up to that rate, allowing the borrower to make the walk up the ladder without again risking his home.

I would not be for an overall cap on what the loans could be, but I think a gradual cap as rates go higher of more than 2 percent makes sense. These changes I would make should not overshadow the basic consensus that exists on the subject of home equity loans afforded by Congressman Price. There is a feeling in Congress, that consumers are being led into the home equity loan market without enough information and protection.

There is agreement that the advertising of this hot new banking product has often been deceptive, sometimes outrageous. I hope this subcommittee will continue to give careful consideration to these emerging problems. Given the past record of Chairman Annunzio, I am sure that will happen.

Thank you again for the opportunity to testify before you this morning, Members of the committee and Mr. Chairman.

[The prepared statement of Mr. Schumer can be found in the appendix.]

Chairman ANNUNZIO. Thank you very much once again for a very enlightening statement. I will have some questions later, but before we hear from Governor Seger, I want to say to Congressman Price and Congressman Schumer, as Members of the full committee, if you have the time, I invite you to sit with the subcommittee in order to listen to the second panel.

And now it is my pleasure to welcome once again to the subcommittee—I think you were the former banking commissioner in the State of Michigan, right, who is now a member of the Board of Governors, Federal Reserve System, Martha Seger.

Ms. Seger, you can proceed in your own manner for about 10 minutes and your entire statement, without objections, will be made part of the record.

STATEMENT OF MARTHA R. SEGER, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Ms. SEGER. Thank you very much, Members of the subcommittee. I appreciate the opportunity to appear before this subcommittee to discuss home equity lines of credit and H.R. 3011. The proposed bill would amend the Truth in Lending Act to require creditors to provide consumers with more information about home equity programs in advertisements and in initial account disclosure statements.

The information that we have regarding home equity lines of credit shows that there has been a substantial growth in this type of credit since 1984, as has already been mentioned and we estimate the outstanding balances were about $40 billion at the end of 1986. We believe the total today may run around $65 billion and could reach as much as $75 to $80 billion by the end of this year.

This rapid expansion is probably attributable to several factors. For example, the plans have provided consumers convenient access to credit at interest rates that are relatively low compared to other means of financing consumer spending. Tax laws phasing out the deductibility of interest for nonmortgage consumer debt have made home equity loans more desirable to tax conscious borrowers. In

addition, competition among financial institutions to offer diverse financial services to their customers has resulted in vigorous marketing of home equity lines, often at low introductory interest rates and discounted fees.

Recently, the Board and other bank regulatory agencies changed the reporting requirements for credit secured by real estate to provide more complete and accurate information on household borrowing through home equity lines of credit. This change should provide more accurate information for an important segment of the market, and enable us to better gauge the growth of this type of credit and the effect it is having on other consumer borrowing.

In addition, the Board has conducted consumer surveys this year to gather information that will allow us to better understand consumer usage of home equity lines of credit. Much of the debate about home equity loans has focused on the current disclosure requirements for these loans, and whether the present requirements are adequate. The sponsors of H.R. 3011 have sought to address some of these concerns by introducing legislation to require additional disclosures for home equity loans.

Since home equity programs are more complex than other types of open-end credit plans, and pose a greater risk to consumers if they fail to understand the terms and conditions of the plan, the Board, like the Congress, is concerned about whether the existing disclosure requirements under the Truth in Lending Act and our Reg Z ensure that consumers receive adequate information about these types of loans when they contract for a particular plan. In our review of H.R. 3011, we find that the Congress has identified many of the issues that we ourselves have targeted as major areas of concern that possibly could be addressed through regulatory action.

During the past year, board staff has been considering the issue of home equity lending within the context of Truth in Lending disclosure requirements. In addition, the Board's Consumer Advisory Council formed a subcommittee at the beginning of this year to look into the issue and has discussed it at its past two meetings with us.

The staff's analysis indicates that the current regulatory requirements for open-end credit may not adequately reflect the complexities that are present in most home equity programs. Specifically, the staff has focused on the content, timing, and format of the disclosures required under Reg Z as possible candidates for regulatory change. At this time, board staff is preparing a proposal that would amend Reg Z to address these issues and expects to present their recommendations to the Board of Governors sometime next month.

Although the review is still in process, and neither the staff or the Board has made any firm decisions about what can and should be done, I would like to share with you some of the particular issues that we have been considering. Under current requirements, when a home equity plan is opened, a creditor need only give those general disclosures that I previously outlined.

Creditors are not required to disclose certain items, such as their right to unilaterally change the terms and conditions of the plan, or the possibility that a balloon payment may be required as part of the plan. It is conceivable that Reg Z could be amended to re-

quire disclosure of these features. There also may be a need to require more disclosures in home equity line advertisements, as has been suggested earlier.

Some questions raised in this regard include whether so called teaser rates are adequately disclosed as only lasting for a limited time period and whether disclosing a payment term in an advertisement should require disclosure of other material terms, such as the annual percentage rate or fees to be charged under the plan.

In considering any additional disclosure requirements, however, the Board is guided by the principle that disclosures should provide consumers with essential information, without overloading them with less important information or unnecessarily raising creditors' compliance costs.

Another area we have identified as one to look into concerns the timing of the disclosures. Reg Z currently permits open-end credit disclosures to be given anytime prior to the first transaction. In the case of home equity lines of credit, therefore, consumers, in many cases, do not receive disclosures about the full terms and conditions of the plan until the closing. Since most home equity credit plans involve large up-front fees and tend to be more complex than other types of open-end credit, an argument, I believe, can be made for requiring disclosure of the fees, terms and conditions of such plans at an earlier time in the credit-granting process.

Finally, concern has been expressed that consumers may not fully understand the terms and conditions of the programs. This concern may be due, in part, to the complexity of these plans and the fact that the underlying contracts could run several pages in length. Currently, Reg Z does not require any special format for open-end disclosures. As a result, in most cases, the disclosures given for these plans are not segregated from the contractual provisions or highlighted in any standard manner.

We believe that consumers should be alerted to the most important terms and conditions of the plans for which they contract. To the extent that the current regulatory requirements fail to meet this goal, it might be necessary to require that disclosures about these plans be segregated from other information.

The Federal Reserve Board certainly shares the goal that consumers receive adequate information at a relevant stage of the credit-granting process when they contract for home equity loans. We believe that it is particularly important that consumers understand these programs since they arguably pose a greater risk because of their complexity, the large credit lines generally involved, and the possibility of losing one's home. Therefore, we as a group personally look forward to working with you on this important subject, and I thank you very much, and I would be more than happy to take any questions you may have.

[The prepared statement of Ms. Seger can be found in the appendix.]

Chairman ANNUNZIO. Thank you very much for your testimony, and we appreciate your appearance before the subcommittee this morning.

As I mentioned in my opening statement, the purpose of these hearings is to try to bring out all of the facts as to what we can contribute to a major, major problem that could very well develop

in this country. As you all know, it hasn't been that long since we were faced with the energy crunch. We have seen these—what they call money brokers—take these oil people into some of the largest banks in this country and foolishly made loans at astronomical rates of interest hitting as high as 25, 26, and 27 percent.

But when the people who made the loans could not pay back these loans, we also saw some of the largest banking institutions in this country, and I won't mention their names, went belly up or they were taken over by the FDIC and run by the FDIC. And even to this day we have people in Oklahoma and Texas, banks and individuals, who were wiped out of all their savings.

These are the things that can happen to people who supposedly have some sophistication in loaning money and in borrowing money, and we saw this happen not too long ago, and it is continuing in many other sections of the country. So, those are the answers we want. We are dealing here with a product where the more equity you have in a home the more you can borrow, but who has this equity?

Surely not someone who is 20, 25 or 30 years old. It is the senior citizens, people who have had their homes over a long period of time and have paid into those homes. They have the most equity, and they have the most to lose. So Mr. Schumer, on your cap, I made my point.

I am thinking about something you said in your statement about the middle- and upper-class people, and that they got there in society because of the hard work they performed. Now if you have a cap of 2 percent a year, as you suggested, over a 5-year period, that cap could be 10 percent. Would you make some comments about how we would tighten this up?

Mr. SCHUMER. Well, Mr. Chairman, this cap is not a cap of an overall interest rate. If, for instance prices should go up, interest rates should go up to 20 percent, anyone who has a variable rate loan, as Fannie Mae does it now and home equity, as I propose, is only going to be hit 2 percent a year.

People make a choice. When we took out our mortgage, my wife and I had to make a decision whether we wanted a fixed rate and pay a higher amount or a variable rate and start off at a lower amount and go up. And we made that decision, but my difficulty is rather a transitional difficulty. If interest rates should climb dramatically in a 1-year period—they rarely climb more than 2 percent, but it has happened. People who have actually, with eyes open, opted for a variable rate mortgage can then actually not be prepared for such a huge increase in the course of a year, not make the necessary changes in their family budgets.

When the variable rate mortgages came out, there was a danger of people being really stuck. They rejected an overall cap, but they said a yearly cap just to limit how quickly things could rise made sense and in effect the variable rate mortgage I signed for my home has just that provision, and I knew it was a relief to me and my wife knowing that if, God forbid, interest rates went up very high, we couldn't in 1 year of our mortgage payments double or go up by 50 percent or whatever.

Chairman ANNUNZIO. The difference between you and the average person is that not everyone has a law degree and has some ex-

pertise in signing a mortgage. You know what you have signed. You know a variable, but my children ask me about a variable rate interest from the very beginning, day one in this committee. Despite the fact that many of my good friends supported variable rates, I consistently opposed the variable rate legislation for that reason, because young people are not sophisticated enough to make that determination.

Mr. SCHUMER. That is a disagreement we have. I would not eliminate variable rates, but I would limit the rise. I wouldn't say disclosure is enough, so I would say I am just sort of in between your position and the bill.

Chairman ANNUNZIO. All right. Now, Mr. Price, you mentioned something about these equity loans comparing them with second mortgages. At first blush, when you read some of the advertising on equity loans, you wonder why people don't go out and take out a second mortgage. It appears to be like a second mortgage on the home, but it is refined and it is dressed up to make it look like another beautiful gift that somebody is offering you free, but they don't call it second mortgage.

Could you, for the benefit of the panel, tell us what the difference is, some of the harm that is being done.

Mr. PRICE. Well, you are right. For all intents and purposes this is a second mortgage and it contains the same risks for the borrower that a second mortgage would carry. There are advantages for many consumers. These loans have been generally offered at lower rates of interest. These are, in most cases, variable rate loans, but now the rates are low.

They also offer an open line of credit, so they do differ from traditional closed-end second mortgages, but the point of this bill is that they do put the borrower's home at risk and therefore a full and early set of disclosures is desirable.

For that reason we are, in this bill, essentially bringing the treatment of home equity loans into line with the treatment of other adjustable rate mortgages proposed in the Regulation Z revisions.

Chairman ANNUNZIO. As I mentioned in my opening statement, what does the consumer do that has one of these equity loans when the rate reaches 21 percent? What happens to this consumer?

Mr. PRICE. Well, consumers conceivably could be faced with very difficult and threatening circumstances if that kind of drastic rise in rates occurred. That is a risk that the consumer incurs at the time of borrowing and he needs to be fully aware of it.

Chairman ANNUNZIO. Now in our whole social programs we have built certain pillars to keep our economy up. We have unemployment compensation. We have social security. We have food stamp programs. All of this is to keep the pillars of our economic system up because, as you know, in 1982 and 1983 when we didn't have these pillars our economy went belly up, the whole community.

So it seems to me what we have to do is create some kind of a pillar so that these people who are making these equity loans can understand it. Maybe sometimes frighten them, so they can really understand what they are up against in this particular market.

We are talking now about if the rate goes up and they have these 2 percent above prime loans and the prime rate continues to go up, and I have seen that happen right outside the suburban

areas of Chicago when that area went 20, to 21–22 percent. A lot of the large developers in the suburban areas all went out of business. I know that, Mrs. Seger. They went out of business, and they were jumping out of windows.

Their entire life work, companies, all went under. That could very well happen to the homeowners in this country, and that is why we have to create some kind of a pillar.

That is what I want to know. That is the purpose of these hearings, to see what the best way to go is without mandating, because if you start mandating you have, again, the government interfering. Thank God the government interferred in unemployment compensation, because you see that is money that people spend, and as you spend money, the stores and service businesses all profit from that kind of money.

It is cash that keeps flowing into the economy and it keeps the factories moving and manufacturing. Mr. Price, do you have any comments?

Mr. PRICE. Well, I think the kind of advertising of these products we have seen does give rise to a great deal of concern about people's ability to make rational decisions.

We have no indication that there are rampant widespread abuses. In fact, I think most financial institutions have been responsible in the kind of information they have furnished and the way they have dealt with consumers. But we see some troubling signs of partial and misleading claims in advertising. And in general we have a problem with people getting into these obligations before they are fully aware of the ramifications. The Federal Reserve has already recognized that in the case of adjustable rate mortgages, people need to know more, and they need to know it earlier.

What we are saying is that most certainly home equity products fall into this category and that key terms of these loans ought to be fully known to the consumer at the time of application. Let me also stress, Mr. Chairman, that we have in this bill tried to identify the truly essential indicators that consumers need to know about.

I don't think we are going to serve consumers well if we just require massive disclosures that will result in page after page of fine print. We need to pay more attention to what the truly critical indicators are, how they can be isolated and displayed effectively so that people in a relatively short period of time, without lengthy explanation, can see what is at stake and decide if the home equity loan is the best product for them. Having made that decision, the consumer then can compare the products offered by various institutions.

Chairman ANNUNZIO. Mr. Hiler.

Mr. HILER. Thank you very much, Mr. Chairman, I applaud the chairman for holding these hearings, and I want to applaud the gentleman from North Carolina for his diligent work in this area.

I have several questions and maybe one comment. The chairman referred to the kind of pillars that help maintain society and maintain the economy when we have a down turn. You mentioned unemployment compensation and social security, etcetera. I think one of the keys to both of those programs is that the employees, during their entire working lifetime, pay for that insurance; that they

take lower wages at the time that they actually put in the hours of labor in return for having that insurance protection under unemployment compensation or social security, so it is—they have paid in fact for that benefit that they get.

The government decided years ago that some type of forced program in this area was necessary to provide the protection so there is some slight difference with this particular issue. But I think the chairman—I agree with him when he talks about this pillar concept.

Mrs. Seger, it is nice to see you again. Incidentally, I appreciate your helping me out yesterday with some of my constituents. How does this bill duplicate existing regulation or existing authority under other law?

Ms. Seger. Well as you know, the Truth in Lending Act that was passed by Congress about 20 years ago gave the Fed the job basically of implementing a regulation which we call Regulation Z to deal with, you know, the disclosure of involving different kinds of consumer loans, and we have some—I am told. I am not a lawyer, but I am told we have some latitude already to deal with disclosures of home equity lines of credit.

This is a new enough instrument that it has—and it has just come on in volume dramatically in the last year or two and so we are, as I indicated earlier, trying to feel our way along here as to how we should deal with it, but we do have some authority, I am told, to adjust requirements we now have for open lines of credit which is what this is.

And the staff is going to have a proposal to the full board by early next month, and you know, on what changes we should be making that are specifically identified with home equity lines.

Mr. Hiler. Would the Fed welcome some input or direction from the Congress in this matter?

Ms. Seger. Well, I hope we are always open to input from——

Mr. Hiler. Everywhere but domestic monetary policies.

Ms. Seger. Well, I would even listen to you on that so—it is very complicated and we always have to keep balancing the extent of the problem and the, you know, cost of compliance against the, you know, proposed requirements for disclosure, etcetera. And so far, frankly, we have received no complaints from the Fed about home equity lines of credit. Now we have had questions asked, you know, about various programs, but we have not been swamped with complaints from consumers which is sort of surprising.

Mr. Hiler. One of the aspects of the bill is it would direct the Fed to come up with a kind of a consumer handbook as it relates to home equity loans, and I know the Fed has done this in some areas.

Is this something that you can come up with fairly easy? You are planning to do this already or——

Ms. Seger. Here is one example where we are actually ahead of the curve. We have a brochure in development right now on home equity lines, on the wise use of them, how a consumer can make the judgment, you know, as to what portion of their equity they should put in hock, so to speak, and we are actively working on that already, and it is—I hope going to be sort of along the same

lines as our brochure on adjustable rate mortgages which has gone along very well.

That is a project I had myself, and I am very interested in things being written in understandable English. Maybe it is because I am not a lawyer, and I don't understand it if it is written in legalese, but we want it simple, direct, a lot of good examples and something that is short and something that consumers would actually read.

It is being used very extensively. The various lenders around the country actually give these out when the individuals come in to apply for an adjustable rate mortgage, and I would hope the brochure we are doing on home equity lines could be used in the same way.

Mr. HILER. My time is expired. I have one more question which I would put off, but I would close with maybe a 15-second statement.

I can see Mr. Price and Mr. Schumer have strong views on this legislation. I can see the outlines of the discussion that is going to erupt over this issue. It will take place maybe not so much in the subcommittee, but probably definitely at the full committee when we get to this discussion over whether there ought to be a limitation in the area of the amount that the variable rate could go up in a year or whether there ought to be some limitations on balloon payments, or some other limits on the terms of the loan.

As you know, Mr. Price, Mr. Schumer is quite an active individual in the area of legislation and our chairman is second to none in terms of activism. I look forward to the eventual markup of this legislation, both in subcommittee and full committee, as I think some of the arguments will become crystallized. I will continue to welcome comments from the Fed. I thank you Mr. Chairman.

Chairman ANNUNZIO. Ms. Pelosi, any questions?

Ms. PELOSI. Yes, Mr. Chairman, I have a couple of questions. Please forgive me if they seem to be ground you have gone over in previous hearings.

Mr. Price, again, I thank you for your legislation. I have a couple of questions. You may want to direct how they are answered because I will just toss them out.

As Mrs. Seger mentioned, in the 20 years since Truth in Lending, a lot has happened in our economy. The growing consumer debt is a problem. A 6 percent interest rate mortgage which 20 years ago might be listed on your balance sheet as a liability, today might be considered an asset, given the potential for mortgage rates that could be charged. Although I heard what Mrs. Segar was saying about the Truth in Lending giving you some latitude as the lawyers may have indicated for this, do you not see a need for legislation, what with the increase in communication, and the potential increase in interest rates.

Ms. SEGER. Well, as I said not very clearly, we do think some changes need to be made, and we are looking into the particulars trying to, as I said, balance off the, you know, the costs of additional disclosures against the presumed benefits from them and these are not—I am discovering easy calls.

I mean it is very complicated and we are—we are dealing with this right now. Now, again, not being a lawyer, I don't know for sure that we have all the authority we need under the existing law to do this unilaterally. I would hope that if we did have the author-

ity and existing law, but we thought it should be done that—I mean even if you weren't having this hearing, we would be coming to you and asking you for assistance, you know, to get the law changed so that we could do it, but we definitely are committed to, you know, improving the disclosure for home equity lines of credit. That is a commitment, and we are also committed to this brochure. As I said, it is underway.

Ms. PELOSI. What would happen in regulations that you would write should Mr. Price's legislation pass? What would the regulations say? How would that read? In other words, what would be the downside for an institution that did not comply, but which continued to—I won't use the word, mislead, but overpromise the consumer?

Ms. SEGER. Since I am not a lawyer, I may have to get some help from a staff person who is behind me to tell you what the penalties are. There are specific penalties and I know they are quite severe.

Our legal advisor just said there are legal liabilities and so cut if off at that.

Ms. PELOSI. Did you find that the truth and savings legislation strengthened your hand with the institutions?

Ms. SEGER. That is fair to say. I really believe we have got a lot of financial institutions in this country, like 14,000 and some odd banks and 3,600 savings and loans and I don't know how many thousand credit unions and I really think that most of them try to deal in an above-board, open way with their customers. Obviously there are some slime balls around at any particular point in time. Unfortunately that is probably what you are hearing about. But nevertheless, I really think that the intent of most lenders is to please their customers.

After all, they are not going to be alive very long if they don't please most of their customers most of the time. So, I think that often it is a matter of drawing to the attention of the financial community that there is a problem and often you can cooperate and get some of those things taken care of in a rather easy manner.

Ms. PELOSI. Thank you, Mr. Chairman. May I ask one more question of Congressman Schumer?

Is your opposition to a cap on the interest rate related to the availability of credit?

Mr. SCHUMER. I am not opposed to all caps at all times but my bias is let the free market work when it can. In this area we have many, many, many different lenders. There is hardly a oligopoly. They are offering many different terms, as Governor Seger stated. Most of the institutions are complying so that if, for instance, there were 15 issuers, all issuing at the same rate, and there was no crack in the market, I would advocate some kind of cap.

That is not the case here and so, therefore, I don't think a cap is necessary. It should be a last resort, in my judgment. Not never used, but used sparingly and haltingly. On the other hand, in terms of the rises, the 2 percent per year, that is to me a different problem and a different situation.

It has already been done by Fannie Mae and I think with the Feds approval on adjustable rate mortgages, which are analogous to home equity loans.

Ms. PELOSI. Thank you.

Chairman ANNUNZIO. Mr. Schumer, as you know credit card interest rates have shot way up. From what you just said, would you support a cap on credit cards?

Mr. SCHUMER. It is a good question and I am sure we are going to be debating it rather soon. Let me say that initially I thought a cap was necessary, because when I started the drive on credit card interest rates just about every one was at 19 percent. Now you have many different companies offering lower rates, in part because of consumer awareness. So my inclination there, given the maxim I follow anyway, would be disclosure, if you have that high interest rates for the ones that are still charging high on every ad, every application, let the consumer make a choice and if competition isn't furthered, which I believe it will be, I would then consider a cap but I don't think we need a cap at this point because of the cracks in the market now.

Chairman ANNUNZIO. I am not going to rebut you at this time. We will save it for the Floor.

Mr. SCHUMER. Fine. I look forward to it.

Chairman ANNUNZIO. I sure would like to know who these financial institutions are who are lowering their rates to a reasonable rate.

Mr. SCHUMER. Mr. Chairman, I think we probably have a different philosophy. You would say there are some rates too high regardless, that is why you are opposed to variable rate mortgages at all, etcetera. I have a different philosophy than that. I don't like oligopoly but I don't think in barring oligopoly or monopoly this Congress ought to be setting rates.

Chairman ANNUNZIO. I think I have been very reasonable with financial institutions. Those charging 15 percent, I have said nothing about. I think that is a reasonable return on their money. But I am against, as you are, the extortion rates that are being charged. Institutions you find that are charging 16 or 17 percent, are very low in comparison to those charging 17 and 18 percent. They far outweigh the people that are charging the lower interest rates. For that reason I became convinced that we have got to have a cap.

Mr. SCHUMER. I understand.

Chairman ANNUNZIO. I won my fight in subcommittee. I didn't lose it at the full committee because of a gentleman's agreement. I would not ask for a vote. There wasn't a quorum present that day, you see. So now we will wait until we get to the floor of the House. Whatever the decision of the Congress is, that is my decision. But at least we have tried to make a fight.

Mr. SCHUMER. Fine.

Chairman ANNUNZIO. Mr. Wylie.

Mr. WYLIE. Thank you very much, Mr. Chairman.

I am a cosponsor of this legislation because I think it is more of a statement of principle than it is over-restrictive legislation. But I think the most significant statement that was made for me this morning was that this is a new enough instrument that we are not really sure what it is.

I thought it was a fairly straightforward instrument up until this morning. You mentioned rate by surprise, Chuck. You mentioned a case here, Barclay's Bank of New York, and pointed out that in the

case of traditional first mortgages there is kind of a restriction in that they can't sell them in a secondary market unless there is this cap. Wouldn't that also apply to the home equity transactions?

Mr. SCHUMER. No, it hasn't. I think it ought to be.

Mr. WYLIE. In other words, home equity loans should be made a separate financial instrument. If we apply this to what you have found in your own experience—and you have a variable rate mortgage with a cap on your own home loan; is that correct?

Mr. SCHUMER. That is correct.

Mr. WYLIE. Then an interest rate cap would meet your objection as to what is happening in the home equity lending market now?

Mr. SCHUMER. That is correct.

Mr. WYLIE. We will have to find that out. The chairman pointed out that in some cases you can get a line of credit through this so-called home equity loan and get a credit card. Now, if you get a credit card and apply it to that home equity, then the charge is disclosed under the Truth in Lending law already, isn't it, Governor Seger.

Ms. SEGER. The credit card itself would be, yes.

Mr. WYLIE. The rate that applies to that credit card. But then, Chuck, if it is a home equity with a credit card attached to it, to use as kind of a draw or a debit card, is there a loophole there under the Truth in Lending law that says that rate——

Mr. SCHUMER. I think that would be, Mr. Wylie. That is another area to explore. I think it is a good one. Another fertile field.

Mr. WYLIE. Those are a couple of questions that occurred to me. The Consumer Bankers Association has a statement I would like to include in the record. It is my understanding that they asked to testify but the next panel which is coming up was pretty full already and was set before they put in their request.

I would ask unanimous consent their statement be included in the record at this point.

Chairman ANNUNZIO. Without objection, so ordered.

Mr. WYLIE. Thank you, Mr. Chairman.

[The prepared statement of the Consumer Bankers Association can be found in the appendix.]

Chairman ANNUNZIO. Thank you, Mr. Wylie. For the benefit of Mr. Schumer, I would rather have him on my side than against me. I want to thank all of you for your excellent testimony. We have been dealing with the situation where the average person doesn't like to admit they have a problem. Here they have paid all these years. They have built up all this equity, and somebody comes along and waves this magic wand and somebody gets a new car, somebody gets an education.

That is the reason, Mr. Price, we have to let the public understand what the difference is between an equity loan and a mortgage, the second mortgage. People don't like to say they have a second mortgage. They are as opposed to the fact their home is paid. They think this is some kind of sophisticated instrument. I have been to many meetings in my district, many social events, where they know I am a Member of the Banking Committee and chairman of the Consumer Affairs Subcommittee. They say, you know, Mr. Congressman, I now have an equity loan, boasting about it.

Mr. WYLIE. Mr. Chairman, I don't think you need it but your microphone is not on.

Chairman ANNUNZIO. Thank you, very much.

Mr. WYLIE. Mr. Chairman, I would like to add one caveat there. You mentioned the people who are making these loans. People who are taking out equity loans—and I think Governor Seger alluded to the fact there haven't been any substantial number of complaints so far. I certainly haven't had any. They are not dumbbells. They are usually people who have over the years built up an equity in their home and they are fairly sophisticated as far as being borrowers are concerned.

I think that might be one aspect but I do feel like there is probably an area here where we need to have some additional rules.

Chairman ANNUNZIO. That is true, but you can't ever compete with the sophistication of the oil companies and the big banks. There is no one who has sophistication once the interest rates go to 20 percent. Sophistication goes out the window and the home goes out the window. What bothers me is what these banks and thrifts, and savings and loans, and all these other lenders are going to do with all these loans if, God forbid, the interest rate goes back up to 20 percent.

Thank you very much. Your testimony has been very enlightening. I think we have added something to the discussion as far as the future of equity loans are concerned.

The House goes into session today at 12 o'clock. About 10 minutes after 12 I am managing the Mint Authorization bill, so I am going to leave about 12 o'clock. We will have someone else in the Chair. This morning I welcome all of the panelists. I am delighted that you are here.

I am going to assign 5 minutes to each one of you to summarize your statement, and then I will ask unanimous consent that all your statements in full be printed in the record. No one is going to bang the gavel at 5 minutes, but I would like to assign the time and do the very best we can under the circumstances.

I welcome Mr. Alan Fox, Mr. Abt, Ms. Meier, Mr. Kirkpatrick, Mr. Pohl, and Mr. Wood to the hearings this morning. Our first witness will be the legislative representative of the Consumer Federation of America, Mr. Alan Fox. Mr. Fox.

STATEMENT OF ALAN FOX, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. FOX. Thank you very much, Mr. Chairman, for the opportunity to testify on this legislation which the 230 member organizations of the Consumer Federation of America regard as one of the most important issues facing our members. I want to commend Congressman Price for the introduction of this bill, Congressman Schumer for the valuable additional input he has put in on this subject and, of course, commend you, Mr. Chairman, for holding these hearings at this time so soon after the introduction of the bill.

As some of the advertisements Congressman Price pointed to indicate, home equity lines of credit often sound too good to be true. There is a reason for that. Like most things that sound too good to

be true, that is the fact. They aren't true. Home equity loans are inherently dangerous game for homeowners. The homeowner who takes out a home equity line of credit is betting the house that he or she can predict what interest rates and economic conditions are going to be like for the next 10 to 20 years, and they are betting that they can do a better job than the bank or other lender that is offering that home equity line of credit, in a circumstance where not only does the lender have all the high cards, but the lender can change the rules any time it wants. I think the best description of this unequal circumstance was made by a banker, by the president of the Tinley Park Bank, in Tinley Park, Illinois, when he said that home equity lines of credit are, and I quote, "awfully attractive for a banker, especially a banker who doesn't care what happens 7 years from now when his customers have run their credit line up to the limits with casual purchases like neckties and food processors and can't find the cash to repay the whole thing at once", end of quote. I couldn't have said it better than that.

Home equity lines are dangerous to consumers because there is no balance to home equity lines of credit. The lender has little or no risk. The consumer has all the risk. For every one of the attractive terms that was featured in one of the advertisements Congressman Price pointed to, there is an equally unattractive feature that somehow gets left out of the ads and left out of the loan documents. The advertisement promises low monthly payments. The other side of low monthly payments is that if you make those payments at that rate, you are incurring high indebtedness even after years and years of payments. The homeowner may end up owing as much after 10 years as they did at the beginning of the line of credit.

Does a home equity line of credit offer easy access to credit? Those that do also provide easy erosion of the equity in the home. The home is most families largest savings instrument and we believe Congress ought to be concerned about the conversion of the American home from a savings instrument to a debt instrument. That has profound implications for the economy and it is certainly something that the subcommittee should be looking at.

The advertisements promise low interest rates. Those low interest rates are teaser rates that are generally good for only a few weeks or at most a few months. They are replaced by variable rates that under current economic conditions are going to go nowhere but up. They are generally tied to the prime rate and the question we should be asking is whether we are ready for home equity lines of credit that are tied to an 18 to 20 percent prime rate like the prime we had only a few years ago.

Are the fees low? Well, some of the fees are low now but the terms in those contracts are subject to unilateral change by the banks. Home equity lines of credit are landmines. When they explode they can destroy the consumer's home. They can be tripped off by any of several factors, by income loss, the equity in the home doesn't pay the loan. It is the consumer's income that pays the loan. It ought to be clear that the equity in the home protects the lender. It doesn't protect the borrower.

What will happen to consumers down the road when economic conditions cut incomes, when two-earner families lose one income

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due to illness or other circumstances? That is when the complaints will start coming in to the Federal Reserve Board, not today when the rates are low and people are drawing on the lines rather than paying them off. High interest rates can trip off these landmines. We found and Consumer Bankers Association found that the prime rate plus about 2 percent, give or take a little bit, is the most common interest rate used on home equity lines of credit.

The prime is now about 8¾ percent. That is up 1¼ points just since the beginning of this year. It is a similar rate to what prevailed in August of 1978 when the prime was about 9 percent and it had also gone up by a point and a quarter in the previous year. It took just over 2 years after August 1978 for the prime to climb 10 more points.

We have not found very many home equity lines of credit that have any limitation on the increase in rates. The increase in payments that would be incurred if the interest rate does go up 10 points in 2 years or 10 points over any period of years is enormous. That ought to be a serious matter of concern. It is a serious matter of concern in other mortgages.

Congressman Schumer referred to Fanny Mae provisions for regular adjustable rate mortgages. The secondary market, through Fanny Mae and other agencies, in fact has imposed a de facto 5 percent lifetime rate cap on other adjustable rate mortgages. Very, very few adjustable rate mortgages being written today have anything other than a 5 percent lifetime rate cap but home equity lines of credit can easily skyrocket by 10 points or more if the prime rate takes that sort of increase.

I have used up my 5 minutes. There is much more to say, but I think it is clear that Congress ought to be looking at the need for some action. We don't believe the Federal Reserve Board will act very quickly to provide the sort of disclosure requirements needed. They certainly won't want to provide the sort of substantive requirements we believe are needed to protect consumers against these very, very dangerous products.

Thank you.

Chairman ANNUNZIO. Thank you, very much.

Mrs. Meier.

STATEMENT OF MICHELLE MEIER, COUNSEL FOR GOVERNMENTAL AFFAIRS, CONSUMERS UNION

Ms. MEIER. Thank you very much, Mr. Chairman.

Chairman ANNUNZIO. You are the counsel for Governmental Affairs of the Consumers Union.

Ms. MEIER. Yes, thank you, with Consumers Union. We very much appreciate the opportunity to testify here today and congratulate you for moving quickly in addressing an issue of great importance to all consumers. And thank you, Congressman Price, for introducing the first piece of legislation on this important issue.

The trepidation with which my organization regards the proliferation of these new mortgage instruments is reflected in the heading on a major article in our November, 1986 issue of Consumer Reports magazine, the magazine we put out. It was, "Should You Hock Your Home?", reflecting the caution with which we counsel

consumers in their approach to home equity lines. We think there are inherent risks in them.

Looking more closely at the specific features of this inherently risky instrument our concern is even heightened. Both Consumer Federation of American and Consumers Union conducted surveys earlier this year in which we uncovered abusive particular features in home equity lines that we think, in fact, make home equity loans inequitable. In the Consumers Union survey we found that 93 percent of the lenders out of 45 lenders surveyed had no rate caps, no rate caps at all. Consumers under these programs would be hit with repayment shock possibilities and, of course, the possible high risk of foreclosure if rates went as high as the prime did in 1980.

Sixteen percent of the lenders in our survey required balloon payments where the consumer would be required to make a full repayment on the outstanding principal in one lump sum.

One thing that was very unsuspected in the course of our survey was finding out from a number of lenders that they reserve the right in their contract document to unilaterally change the terms of the loan after the loan has already been closed and the loan document signed by both parties. We hadn't suspected to run across such an obviously abusive feature when we designed our questionnaire, therefore, it only came up inadvertently when we were almost finished with our surveying. So we weren't able to get a full sense of how pervasive this is in the course of the survey. We did learn from one particular spokesperson for a California bank that indeed, they had invoked that contract provision and changed the formula under which they determined the rate in 1986 and had gotten a number of complaints from their outstanding borrowers.

Since that time, we have had the opportunity to look at a number of contract forms used by home equity lenders and have found these terms to be fairly pervasive. We consider this to be one of the most abusive features of home equity loans that are being marketed and consider it one of our number one priorities for Congressional attention.

We strongly feel that Congress needs to immediately enact legislation to address what is a high risk instrument containing a number of major pitfalls for consumers. The full description of the substantive provisions that we think are required are included in our testimony. I have already mentioned one priority which is eliminating the ability of lenders to midstream, after the loan documents have already been signed, change the terms of the game by varying the formula under which the rate is calculated or even changing the repayment term obligations. That sort of practice should be absolutely prohibited.

We also believe that there should be, as Congressman Schumer mentioned, a prohibition on the ability of lenders to change the variable rate at will by using their own internal prime to adjust their rates into the future—or simply their own whims. There should be an objective outside index that the lender "pegs" its variable rate interest to. Of course, we also heartily endorse the concept of legislated rate caps.

There, very happily, has been an improvement in the case of closed-end adjustable rate mortgages primarily due to the impact, the discipling impact of the secondary mortgage market which, at

this point, only "buys" adjustable rate closed-end mortgages that have lifetime caps of 5 points and 2 point periodic or annual caps. Since there is no secondary mortgage market for home equity lines, we are not likely to see this sort of disciplining effect in the home equity loan market. Therefore, we think it is crucial that Congress step in here and not wait until this burgeoning market puts any more consumers at risk because of rate caplessness.

In fact, I think we should remember that when closed-end adjustable rate mortgages first came on the market, a number of federal regulators did impose cap restrictions. Since then, the secondary market has taken over and caused the market to introduce cap limits. But with closed-end credit, we started off on a cautious note with legally mandated rate caps to protect consumers. Definitely, when we are talking about second mortgage loans, we need to have at least the same amount of protection.

I believe I am also beginning to exceed my time limit. Only one more word on advertising. We think that the advertisements on home equity loans that we have seen are, in may cases, outrageous. Of course not in all cases. We will be doing a brief article in our magazine next month that describes the results of our survey of advertisements in three markets to see how the lenders are complying with their own trade group's guidelines which were put out earlier this year.

For the most part, although we thought that the guidelines were commendable, they did encourage their members to fully disclose terms in ads, those guidelines are not honored or are simply not honored except in the breach. So we think definitely there is a need for legislation here.

Thank you, very much.

[The prepared statement of Ms. Meier and Mr. Fox can be found in the appendix.]

Chairman ANNUNZIO. Thank you for your excellent statement.

Mr. Kenneth J. Abt, president of First Federal Savings and Loan Association of Middletown, Middletown, NY, representing the United States League of Savings Institutions.

Mr. Abt.

STATEMENT OF KENNETH J. ABT, PRESIDENT, FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF MIDDLETOWN, MIDDLETOWN, NY, REPRESENTING THE UNITED STATES LEAGUE OF SAVINGS INSTITUTIONS

Mr. ABT. Thank you, Mr. Chairman. Members of the subcommittee. The U.S. League welcomes this opportunity to share its views on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987.

There has been a considerable amount of expansion of home equity loans during this past year due to the consumer interest in a flexible, attractively priced line of credit that, in many cases, allows an interest deduction under the Internal Revenue Code. Given that home equity lending by its nature typically involves the consumer's most important asset, we wholeheartedly agree that it is appropriate for Congress to review the area and explore whether existing consumer protection mechanisms are truly adequate.

It is my view that most of the concern about home equity lending stems from fear about what consumers might do rather than what homeowners are actually doing in the market place. Our experience is that homeowners are approaching home equity credit in both a cautious and responsible manner and this appears substantiated by survey data developed for the Federal Reserve Board by the survey research center of the University of Michigan and for the Consumer Bankers Association by the McIntyre School of Commerce for the University of Virginia.

Their studies underline one of the central economic facts of home equity lending, namely, that lenders like this line of business because their borrowers are basically self-selected for quality. This quality factor, buttressed by intelligent underwriting, is the lender's primary safeguard.

Just to cite a few statistics on the first 100 home equity loans that we granted at our small institution, the average age was 44. The average income of the family was $51,000. The average home value was $129,000. The average first mortgage existing was $21,000. Interesting to point out here that 25 percent of those home equity borrowers in this first 100 did not have any first mortgage. So they selected this home equity line of credit as their preferable borrowing mechanism even when they had no first mortgage. The average loan to value ratio was 45 percent for those first 100 borrowers and they obviously were being very cautious and prudent about it.

Under these circumstances, we strongly feel that the most appropriate Congressional response is to insure that disclosure mechanisms are truly in place to assure consumers of this product have the information they need to make an informed decision. The U.S. League would oppose dictating other aspects of the home equity loan relationship such as legislating specific rate caps, banning termination clauses, establishing maximum loan-to-value ceilings and forbidding negative amortization.

The marketplace will generate a far more useful and flexible product for consumers that would emerge necessarily by statutorily dictated terms. Given our concerns about unnecessary intrusion into the home equity lending process we are gratified that H.R. 3011 introduced by Congressman Price focuses on disclosure, reflecting traditional Congressional preferences in this area.

If the subcommittee concludes that new legislation is needed, we believe H.R. 3011 represents an appropriate vehicle, though certain modifications would be helpful, as I will explain in a moment.

Our preference, however, would be for Congress to defer any legislation at this time in light of the Federal Reserve Board's ongoing efforts. In particular, the Truth in Lending Act already mandates a right of recession applicable to home equity loans secured by the borrower's principal residence. Consumers are now given a 3-day period during which they can rescind their transaction. Turning to the modifications we believe should be made part of this bill, we note that the bill would duplicate a number of existing Truth in Lending requirements.

We strongly urge that the subcommittee work with the Federal Reserve Board to assure that any new legislation does not overlap with existing law and generate redundant and expensive new pa-

perwork requirements which, not surprisingly, place the burdens most heavily on the smaller neighborhood community institutions like our own.

Second, we urge that any special disclosure requirements should apply only to the borrower's principal residence.

Third, we suggest that requirements for disclosure for home equity loans be made consistent with those governing closed-end credit. This would be accomplished by altering the bill to require that home equity line disclosures be made before the first transaction or within 3 days after application.

Fourth, the bill should be adjusted to limit to the application stage the conspicuous segregation requirement on disclosure.

Fifth, it is impractical to require disclosure of the APR that would be in effect when the credit was first extended, assuming they only took a small portion of their line.

Finally, the phrase "loan at prime" does not strike us as so inherently deceptive as to merit being banned, and we urge you to reconsider this proposed limitation.

In conclusion, Mr. Chairman, we commend you and your colleagues for the promptness with which you are reviewing developments in this home equity loan area. I appreciate having had this opportunity to share our views with the committee, and I might add that I have greatly enjoyed spending my own professional career in the savings and loan business where we deal with people and their money and their homes. We have never offered hula hoop products and we believe the home equity lines of credits are really fine, responsible products for both the borrower and the lender, and I would be happy to answer any questions you may have.

[The prepared statement of Mr. Abt can be found in the appendix.]

Chairman ANNUNZIO. Thank you very much for your excellent statement, but I wouldn't say that too loudly about your hula hoop, because I don't want to get back to the days when you offered all these premiums, you know.

Mr. John H. Wood, chief executive officer of the MassBank for Savings, Reading, Massachusetts, representing the National Council of Savings Institutions.

Mr. Wood?

STATEMENT OF JOHN H. WOOD, CHIEF EXECUTIVE OFFICER, MASSBANK FOR SAVINGS, READING, MA, REPRESENTING THE NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. WOOD. Mr. Chairman, I am pleased to have the opportunity to present the views of the National Council for today's hearings concerning disclosure requirements for home equity loans. I currently am serving as the chairman of the Council's Consumer Loans Committee.

The National Council of Savings Institutions was formed in 1983 by the consolidation of the National Association of Mutual Savings Banks and the National Savings and Loan League. We represent approximately 600 savings banks and savings and loans with total

member assets approaching $500 billion, or 40 percent of the thrift industry's total assets.

Mr. Chairman, the National Council supports the approach of Congressman David Price when addressing the consumer's need for proper disclosure of terms for home equity lines of credit (HELC). We do, however, oppose restrictions or limitations imposed on home equity lending programs which in turn could adversely affect lenders and the availability of the product for consumers.

Home equity lending is an important refinement in the second mortgage products that our members have been offering consumers for some time. These loan products represent a healthy diversification of savings institution's portfolios since second mortgages are shorter term than first mortgage loans, and often carry variable rates of return. Second mortgages and home equity credit lines are financial products that today's consumer expects to find at leading providers of financial services.

As many institutions have attempted to diversify into consumer loan products such as car loans or credit cards, they have discovered a very competitive, crowded market. In the case of automobile loans, for example, the competition from captive finance subsidiaries offering "advertised" rates as low as 1 percent is stiff competition indeed. Savings institutions are ideally suited to offer home equity credit loans since well established consumer relationships (through first mortgage lending) and mortgage lending departments are the foundation for good home equity lending programs.

Home equity loans act as revolving lines of credit in which a qualified homeowner may draw on an established account. The maximum loan amount is based on two factors: the percentage of equity built up in the home and the ability of the borrower to make payments. A study conducted by the Federal Home Loan Bank of New York on June 1, 1987 shows that most home equity loans made by its member banks were limited to 75.5 percent loan-to-value. This means that a 24.5 percent cushion of untouched equity is left.

Home equity loans offer the borrower features not available with unsecured or traditional loans. The first important benefit is cheaper rates. Since the loans are secured by real estate, the borrower can get funds at more attractive rates than are available for a signature or unsecured loan.

The second major feature is convenience. Since the line of credit can be established at one time, and drawn down as the borrower needs the funds; it is easier for an individual to manage his or her debt than otherwise would be the case. This is a major benefit over the traditional second mortgage.

Another important feature of these loans was recently added by the passage of the Tax Reform Act of 1986 which restricted the deductibility of interest on certain loans but retained deductibility of interest paid on debt secured by a taxpayer's primary and secondary residence, within some limitations.

Because the purchase of a home is the most important investment made by most, any loan agreement which could affect such homeownership should be thoroughly understood and assessed by the consumer.

The National Council has supported past efforts to educate consumers on the mechanics of various mortgage products. In 1984, the National Council worked in conjunction with other industry trade groups, the Federal Reserve, and the Federal Home Loan Bank Board to develop The Consumer Handbook on Adjustable Rate Mortgages.

As the Congress approaches the question of necessary consumer safeguards in the home equity lending area, it is important to keep certain things in perspective. First, the highly visible marketing of these programs is very competitive as providers of financial services attempt to maximize lending programs that many feel will be spurred on by the new tax law. However, a recent survey taken by the Survey Research Center (SRC) of the University of Michigan on behalf of the Consumer Advisory Council of the Federal Reserve shows that, "As of April 1987, 6 percent of homeowners had established lines of credit secured by their homes. In addition, 1 percent of homeowners had applied for such accounts but had not yet received approval."

The SRC survey also shows that, "Consumer awareness of the availability of HELC is high (80 percent of all homeowners stated they knew about such accounts). However, 9/10ths of homeowners who were aware of such accounts but had not yet applied for one stated that they were not interested in opening such an account in the near future."

Second, a major portion of the home equity lending business will represent a substitution of consumer debt transferred from credit card, automobile, boat, and other unsecured personal loans. This transfer of debt will represent a savings to the consumer in the form of cheaper borrowing costs. This is also borne out by the SRC study.

As the Congress addresses the issue at hand, the Council would urge that no restrictions be placed on the ability of lenders to structure the loan product, as this will stifle market development. We feel a market-determined home equity loan is the best solution to any problems arising today. We therefore urge Congress not to restrict lending practices, but to allow the market to dictate a workable home equity product.

We wish to commend Congressman Price for introducing a bill which keeps a realistic perspective on the home equity lending market, and addresses potential problems through better informing the consumer and not through the imposition of arbitrary restrictions on the market.

Mr. Chairman, I would like to thank you for the opportunity to appear before your subcommittee today, and I would be happy to answer any questions you might have.

[The prepared statement of Mr. Wood can be found in the appendix.]

Chairman ANNUNZIO. Thank you very much, Mr. Wood.

Our next witness is Mr. David H. Pohl, senior vice president of Gibraltar MoneyCenter, Inc., San Diego, California, representing American Financial Services Association.

Mr. Pohl.

STATEMENT OF DAVID H. POHL, SENIOR VICE PRESIDENT, GIBRALTAR MONEYCENTER, INC., SAN DIEGO, CA., REPRESENTING THE AMERICAN FINANCIAL SERVICES ASSOCIATION

Mr. POHL. Thank you, Mr. Chairman. I am also appearing as a representative of the American Financial Services Association's (AFSA) section on real estate lending. I appreciate the opportunity to appear before you and other Members of the committee here today.

Chairman ANNUNZIO. Very happy to have you.

Mr. POHL. I want to thank you for your indication that the written statement that I have previously provided will be made part of the record here today.

Chairman ANNUNZIO. Without objection, all the statements of the witnesses will be made part of the record.

Mr. POHL. Thank you.

The American Financial Services Association is the Nation's largest trade association representing nonbank providers of consumer financial services. This organization represents a diversified group of companies ranging from those operating offices which are small and independently owned up to those which are owned and operated by the Nation's largest providers of financial services, finance services companies, retailers and automobile companies.

My purpose in appearing here today is to present views on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987.

I would like to first discuss some of the distinctions in terminology and perspective which we encourage the Members of the committee to keep in mind as we proceed in considering this legislation, to mention several areas where AFSA is in alignment with the philosophies represented by H.R. 3011, and finally to address some points of concern with some of the technical provisions of the bill.

First, as the terminology, as has been covered in some of the remarks here this morning, home equity lending typically has referred to the traditional second mortgage type of loan. Often in articles and discussions we hear broad brush references to home equity lending without making the distinctions as to home equity lines of credit, which are a narrower segment of this particular type of lending and as we all know, are a relatively new and dramatic development in this area of home equity lending.

The significance of this entire topic, of course, is demonstrated by the size of the market today when total outstandings in home equity lending are estimated to be at the present time in excess of $225 billion, and as we have heard in home equity lines of credit, the outstandings in 1986 were in the range of $50 billion.

Consumers like home equity lines of credit because they provide a relatively inexpensive and readily accessible means or source of funds. They can borrow as much or as little as they need, depending upon the size of their credit line with the lender. They use home equity lines of credit to consolidate debt, to make home improvements, purchase automobiles and defray educational and medical expenses.

Financial institutions like home equity lines of credit because they attract a more upscale and sophisticated customer who may

continue to utilize other services which are offered by the institution. Also the soundness of home equity lending has been demonstrated by the experience of financial institutions to date. Relatively low delinquency rates support this statement as far as the soundness is concerned, and the statement that I provided for the committee contains some statistics with regard to those delinquency rates.

As far as our alignment on the philosophy of this legislation, AFSA is very active in supporting the principles of disclosure and advertising. We have consumer education activities which are currently underway and which entail that loans would entail disclosure, that loans supplied by equity on a consumer's home would be appropriately disclosed to that extent, the variable rate and payment plans should be analyzed by the consumer to see how they fit into one's household budget. Consumers should seek competent tax advice before taking out such loans and consumers should shop for the terms and conditions which best meet their particular needs before undertaking a loan.

AFSA also upholds a code of ethics which is a condition of membership in the association. This code emphasizes complete and accurate advertising and disclosure of loan terms. The provisions of this code require that members will explain fully to customers the cost, terms and contractual obligations of credit transactions. Also they include the provision that truth in advertising will be a guiding principle of all promotional efforts.

Some of the recent criticisms of home equity lending have included some broad brush allegations that there are widespread problems with disclosures in advertising by financial institutions, that consumers are too unsophisticated to understand the consequences of their actions, that lenders do not disclose terms and conditions other than to deceive borrowers and to gain ownership of the security, the real estate which is securing the loan, and finally, that home equity lending is substantially unregulated.

We would submit that these assumptions are false and that there are not widespread problems. There obviously may be anecdotal horror stories which can be cited to support some of the claims which have been made. But at the present time lenders do disclose terms and conditions and comply with disclosure and advertising standards which are set up already in existing laws at the federal level, as well as at the State level.

Certainly as far as the sophistication of consumers is concerned, a recent study which the Federal Reserve Board sponsored which was conducted by the University of Michigan has supported the finding that consumers who participate in home equity lines of credit and take out these loans tend to be an upscale consumer having a higher median income, a higher education, for example that the median education in this study was 14 years with a median income of $40,000, and a median home equity of $70,000.

I want to emphasize the point that I know you have heard before, but in connection with some of the criticisms that have been made, that lenders are in the business to make loans and not to acquire ownership of real estate which is securing those loans. Responsible lenders certainly look to the creditworthiness of their consumer. They underwrite the loan to make sure not only does

the person have the willingness to repay, but the consumer has the ability to repay the loan.

Foreclosure proceedings generally end up in a loss of money for the lender. The lender ends up with a loss of opportunity to reinvest those funds which are otherwise tied up in the real property and typically, a lender loses money on the resale of property which is acquired through foreclosure proceedings.

Certainly the discussion of home equity lending in connection with H.R. 3011 takes place in a regulatory climate which already sufficiently takes care of the interest of consumers without overburdening lenders with a cost of compliance. We have the Truth in Lending Act and some of the provisions have been discussed here today and are also discussed in my written testimony. We also have the advertising provisions which exist both at the Federal level and in many State laws, and we also have the right of rescission which is a very important feature provided by the Truth in Lending Act.

A number of State laws include disclosure provisions which govern home equity lending and home equity lending transactions. There are also plain English laws in a number of States which apply to this type of lending. As far as H.R. 3011 is concerned, we are in support of the philosophy which is addressing the disclosure requirements and advertising of home equity lines of credit as a step toward achieving a balance between full consumer awareness of the product involved and limiting the cost to lenders for compliance.

We do take some issue with some of the technical features which are covered in my written testimony that have to do with the timing of the disclosures which are required with regard to whether that is required at the time of application or whether it goes to the time of the first transaction. The point to be involved there is there is a question as to whether there is an overlap or a conflict.

In my written testimony we have discussed that more fully. There is a need for a clarification on that point. Also with regard to the reference to a $10,000 amount outstanding, we would encourage reconsideration of that provision to have that referred to $10,000 taken out at the time the loan is initially made and the rate is in effect at the time of the initial transaction.

Finally, with regard to the terminology with regard to a loan at prime, we do want to make sure that it is clear from the ultimate legislation that the use of the phrase "loan at prime" is intended to specifically prohibit that expression itself and not also encompass any use of the word "prime" or use of the prime rate as an index in connection with the loan being taken out.

AFSA is willing to work with this committee in addressing these concerns, Mr. Chairman. I want to thank you and your committee for giving us this opportunity to share our views.

[The prepared statement of Mr. Pohl can be found in the appendix.]

Chairman ANNUNZIO. Thank you very much, Mr. Pohl, for an excellent statement.

Our next witness today, Mr. William T. Kirkpatrick, vice president of the Citizens and Southern National Bank, Atlanta Georgia, representing the American Bankers Association.

Mr. Kirkpatrick.

STATEMENT OF WILLIAM T. KIRKPATRICK, VICE PRESIDENT, CITIZENS AND SOUTHERN NATIONAL BANK, ATLANTA, GA., REPRESENTING THE AMERICAN BANKERS ASSOCIATION

Mr. KIRKPATRICK. Mr. Chairman, Members of the subcommittee, I am William T. Kirkpatrick, vice president of Citizens and Southern National Bank in Atlanta, Georgia. I am also a member of the Consumer Credit Division Executive Committee of the American Bankers Association. In that capacity, I welcome the opportunity to present the Association's views on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987.

The American Bankers Association supports the intent of H.R. 3011 in its efforts to provide simple and understandable disclosure of loan terms to potential customers and to advertise home equity loan products in a responsible manner.

Home equity loans provide a convenient way to access substantial amounts of credit at relatively low rates. Knowledgeable consumers prefer to have the ability to accommodate most of their lending needs on their own, thereby avoiding repeated visits to the bank. In addition, recent changes in tax legislation make these loans particularly attractive, because while interest deductibility is being phased out for most other forms of consumer credit, home equity loans may and I emphasize may, remain a source of tax-deductible credit for many consumers.

Banks and other lenders like home equity loans because they are a secured and relatively simple form of credit. They provide good security for a bank, if managed prudently. Their lower cost in relation to loan size is reflected in the attractive pricing to consumers.

Let me underscore the importance of prudence. The home equity loan is an excellent financial tool for some consumers when offered properly and prudently by lenders and used properly by borrowers. If either fails to recognize the purpose for which it is intended, the risks associated with easy access, rate volatility, and lack of payment discipline, can result in credit abuse and, perhaps in some extreme cases, the loss of the home.

Bankers and other traditional and regulated financial institutions have years of lending experience and generally adhere to prudent loan underwriting practices. Bankers base loan approval on the consumer's ability to repay. In other words, it is not based on equity alone, but on the consumer's total financial strength.

A recent ABA survey shows that banks are using conservative criteria for home equity lending. According to the ABA's 1987 Retail Bank Credit Report, regardless of size, banks commonly reported a loan to value ratio between 75 to 78 percent for both fixed and variable rate loans, well within the standard guideline of 80 percent. The report also found "most banks recognize that questionable advertising might confuse consumers. . ." The survey indicated that the banking industry is already demonstrating a strong commitment to responsible advertising practices.

Like all credit instruments, home equity loans carry a potential risk. But the risks associated with them can be easily managed by responsible lenders and informed borrowers. Because of this belief, the ABA has pioneered public awareness efforts among the financial services industry. Last fall, concerned that some lenders were

not advertising the product in the most responsible manner, the ABA formed a home equity task force to educate lenders. I chaired that task force, and in December, 1986, the task force produced a "Home Equity Alert Kit." It offers guidelines for responsible home equity advertising which we feel the entire lending industry, not just banks, should adopt. We distributed thousands of these kits to bankers and to anyone else who requested them, free of charge, because of our commitment to responsible advertising.

In conjunction with this lender education effort, the ABA also compiled a comprehensive 700 page guide, "The Home Equity Lending Manual" for bank officers. This publication helps bankers design responsible home equity loan programs.

A next phase of the ABA's public awareness campaign was to produce a consumer brochure, "What You Should Know About Home Equity Loans." Giving consumers tips on both the benefits, and most importantly, on the potential pitfalls of these loans and it has been widely recognized for its candor. To date, more than 100,000 brochures have been distributed to the public.

This awareness effort was followed by a video press release designed to educate consumers and the media on the responsible use of home equity loans. Featured in the video tape are Mark W. Olson, current national president of the ABA who is also president of Security State Bank in Minnesota and Alexandra Armstrong, president of a renowned financial planning firm. The video was recently transmitted by satellite to more than 700 TV stations covering every major market in the country and to date, we know that at least 100 of these TV stations have already used the video in their news programs.

We will be happy to make these materials available for subcommittee review.

In effect, much of what Congress is considering to require by law, our members have been doing on a voluntary basis and will continue to do so.

Nevertheless, we support reasonable disclosures of pertinent features of home equity financing products. These disclosures, however, should be meaningful, easily understood, and useful for the purposes of evaluating home equity products. We welcome Representative David Price's efforts to draft legislation to address this issue in a realistic way, and we would like to make some recommendations to help streamline the legislation and improve consumer education on the responsible use of these banking products.

Our written testimony details our suggestions for the legislation. However, I will briefly touch upon some of them here.

The amount of time provided for disclosures should uniformly be 3 business days regardless of how the application is received. Furthermore, it should indicate that the lender's responsibility is to mail the information within 3 business days. The current wording could be construed to require the receipt of the information within 3 days. Once the disclosures are placed in the mail, we can no longer control when they will arrive.

We suggest that the language also be clarified to require that applications be written and provide some elaboration concerning the type of applications which will trigger disclosure. We are concerned about consumers preparing partially written applications and the

fact that those may cause compliance problems and consumer confusion over whether or not partially completed applications trigger disclosure requirements.

In the area of disclosure of any fees imposed, there are instances when specific fee information may not be available at the time of application. Therefore, we suggest that an alternative be offered, the right to offer an explanation of how the charges will be determined if the specific information is not available at that time.

The general wording of the subsection also creates a potential problem on how to disclose some fees such as appraisal fees and title insurance fees. This could be remedied by granting financial institutions flexibility under such circumstances to disclose initially that there are certain additional categories of fees whose exact amounts must be determined, and later permit them to disclose the exact figures within a reasonable amount of time beyond the initial disclosure period.

We support the concept of providing an example to assist consumers as long as it educates them and does not cause compliance problems for banks. Rather than dealing with the specifics of the example in the legislation, we suggest that the bill direct the Federal Reserve Board to have complete responsibility for drafting the appropriate example with the goals of consumer education and so eliminate compliance problems for lenders.

The ABA believes that providing only 180 days for both the issuance of final regulations and their implementation by banks should be amended to allow 180 days for compliance after the regulations have been finalized by the Federal Reserve Board. Otherwise, on such a tight schedule of legislation, there may be haste in drafting regulations and in complying with new regulations.

This increases chances of errors and unnecessary expenses. The result would be confused and misinformed consumers.

Finally, H.R. 3011 should provide that federal law supersedes any State law regarding or relating to disclosures and advertising of home equity financing products. Without this provision, States could create a patchwork quilt of related but inconsistent or different laws that ultimately could be to the disadvantage of the consumer and make disclosure compliance unduly complicated. Many financial institutions market home equity products regionally, and compliance with individual State laws would present unnecessary difficulties.

In conclusion, I want to stress again the mutual concern of the American Bankers Association with the Congress in protecting consumers from the loss of their most important possessions—their homes. We believe that home equity financing products must be used wisely and carefully and we are committed to seeing that happens.

We appreciate having the opportunity to testify on H.R. 3011 and look forward to our continued work with Members of the subcommittee in developing a final version of this bill.

I will be happy to answer any questions that subcommittee Members may have.

Chairman ANNUNZIO. Thank you very much, Mr. Kirkpatrick, for your contribution this morning. Your entire statement will be part of the record.

[The prepared statement of Mr. Kirkpatrick can be found in the appendix.]

Chairman ANNUNZIO. I have the authorization for the U.S. Mint on the floor of the House today, so Ms. Pelosi will be in the Chair, and Mr. Price will ask as many questions as he can of the panel. Before I leave, I want to express my appreciation to all of you for being here. Your testimony will be read carefully as we proceed in the carrying out of this legislation. How long it is going to take, I don't know.

Some people want us to hold it up waiting for the Federal Reserve Board to complete their study. The experiences I have had with the Board have been enthusiastic about waiting for a study, so I will decide with the Members of the subcommittee what we want to do, but I assure you that your remarks will help us—your statements will help us very much in trying to get some legislation out of the committee. So I thank you very much for being here today.

Mr. FOX. Mr. Chairman, I must ask to be excused at this point. I would be happy to answer any written questions, but I won't be able to stay.

Chairman ANNUNZIO. Thank you. We appreciate your being here this morning.

Mr. FOX. Thank you.

Ms. PELOSI. Thank you, Mr. Chairman, for the honor of chairing this meeting. I know you will take good care of us with the authorization bill. I am particularly interested in upgrading the San Francisco assay office to a mint. I look forward to the House taking action on that today. Thank you, Mr. Chairman.

Ms. PELOSI. (presiding.) Has Mr. Hiler left? We will begin with you then, Mr. Wylie.

Mr. WYLIE. Thank you very much. I have too many questions. I think that the panel discussion here this morning has been very educational and informative. I would like to have—I think you, Mr. Kirkpatrick, since you have some experience with this, tell me what is the difference between a home equity loan and the traditional second mortgage?

I thought I knew. I thought when I started here this morning there wasn't any difference, but the more I listen, the more confused I get on it.

Mr. KIRKPATRICK. Congressman Wylie, basically the difference is the traditional fixed rate second mortgage that most people are familiar with came about 20, 25 years ago where someone would go in and borrow $5, $10, $15,000 dollars for a fixed period of time at a fixed rate with a fixed monthly payment. They would pay that off in 60 months, 74 months, be out from under the obligation and the debt would be paid in full.

The new consumer product, the home equity lines of credit are variable rate reusable sources of credit where a consumer would go in and establish a line for, say, $20,000, might draw down $5,000 for college education this year, pay on that loan for 2 or 3 years, but then have the ability 2 years down the road to draw down an additional $10,000 or $5,000 to pay for additional education without having to go back and refinance and pay additional fees.

So it gives the consumer the ability to have basically at their fingertips access to monies secured by the equity in their home and

based on their financial strength to pay for borrowing needs that will require a visit to the bank normally down the road.

Mr. WYLIE. Basic difference, then, in a second mortgage, they needed money to finance the house or payments on the house. They did need the money——

Mr. KIRKPATRICK. Not necessarily. It would be a fixed reason, say, you want to go in and borrow $10,000 to put in a swimming pool.

Mr. WYLIE. I ask the question advisedly there. What if we defined this home equity loan as a traditional second mortgage?

Mr. KIRKPATRICK. I am sorry, sir? I didn't——

Mr. WYLIE. I say what if we define the home equity loan so that it is in the traditional sense of a second mortgage?

Mr. KIRKPATRICK. I think most of the advertising, sir, that ABA has seen and that we do generally indicates that there is a secured lien position on the borrower's dwelling and therefore we do advertise it as a second mortgage.

Mr. WYLIE. Do you have a comment on that, Mr. Pohl? You advertise it as a second mortgage, but it is not a second mortgage.

Mr. POHL. I think, Congressman Wylie, the experience in the industry so far today is that the traditional second mortgage has been addressed as a home equity loan emphasizing a simple purpose transaction as opposed to the home equity line of credit, as Mr. Kirkpatrick indicated, which has particular access.

It tends to be treated and disclosed as a transaction secured by an interest in real estate by the equity in the consumer's home, so I am not so sure that, if I understand your question correctly, that any further regulation or legislation with regard to advertising of traditional second mortgage lending is necessary in that regard.

Mr. WYLIE. What about that, Ms. Meier? I see you have your hand up, and I was just coming to you. I am concerned that if your suggestions are implemented in law we might be overloading the circuit. Aren't most of the suggestions you make in the form of misrepresentations already against the law now and aren't rules and regulations already in place against the kind of misrepresentations that you would suggest are being made with reference to home equity loans?

You can answer that and then answer comments of Mr. Kirkpatrick or both.

Ms. MEIER. Okay. Actually my responses are interrelated. There is fairly comprehensive regulation right now enacted under the Truth in Lending Act on closed end credit regarding both advertising and disclosures. And in fact there is pending now a very improved disclosure regarding closed end adjustable rate mortgages. It has been on the burner for a long time now, but we are hoping that sometime in the next few months it will become effective.

But the open-end regulations have been very weak historically and remain very weak primarily because for a long time the main type of open-end credit has been credit cards. There hasn't been such a need for the full blown disclosure in that area as there has been with closed credit, particularly since open-end credit with credit cards hasn't involved your home as security.

So we think that there is much, much need to in fact bring open-end credit—home equity loans involving both mortgages and an

open-end line—in line with the closed end credit regulations. So, frankly, I don't see any problem having the bill address closed end and open-end just off the top of my head.

I would have to look more closely. There might be some technical problems, but I think just doing that, putting open-end credit on par with closed end credit in terms of disclosure would go a long way toward improving——

Mr. WYLIE. Do you support the Price bill in present form reported out of the Banking Committee?

Ms. MEIER. We would definitely like to see some improvements in it.

Mr. WYLIE. That doesn't answer my question.

Ms. MEIER. Well, it is not—I am just not faced with that situation. We will be working toward improving the bill. At this point I think it doesn't go far enough. I don't know. The timing of the disclosures in the bill is something very important. I think that Congressman Price and our organization and Consumer Federation of America are in agreement about the need to have the timing correspond with the improved timing in the regulation that is now pending that I mentioned earlier regarding closed end adjustable rate mortgages. But right now the bill doesn't really go that far.

What it does is this—if the application is not submitted in person, the disclosure must be made within 3 days after application. Now, that is good, but it is no significant guarantee because at that point the consumer already is going to have submitted his application, gone through that process, paid fees, but still not gotten the important disclosures. So that is one area of improvement that we would like to see.

Again we think that it is terribly, terribly crucial that there be something eliminating this ability of lenders to change terms. Some of my co-panelists have mentioned that their banks have introduced rate caps, but those rate caps aren't going to help consumers if 5 years or 2 years down the road—because the lender is facing that rate cap and wants to get out of it—he just accelerates repayment on the loan and closes it out and requires the borrower to refinance, to open up a new home equity loan. This is what is allowed under those terms.

Mr. WYLIE. My time is expired. Mr. Abt had his hand up. Maybe you want to address that.

Mr. ABT. I want to comment just briefly on the concept of second mortgage and open line of credit. I think it is very important that this product not be labeled a second mortgage because, as I indicated, in our own statistics 25 percent of the borrowers don't have any first mortgage at all. They perceive this to be a very attractive way to borrow with their home as security, and borrowing on very favorable terms.

I think it is very important we not put this in the second mortgage class fix, because it is something much more than——

Mr. WYLIE. You favor passage of H.R. 3011 if it came to the House in the present form?

Mr. ABT. Yes, we do favor passage of that with the method fixes that we recommended in our testimony, and that we have submitted. One point on that: The savings and loans and those regulated by the Federal Home Loan Bank Board are required currently to

provide disclosure on open-end credit, unlike those in other systems, so we are already actively involved in giving disclosure right up front to home equity borrowers.

Mr. WYLIE. Thank you, Madam Chairman.

Ms. PELOSI. Thank you, Mr. Wylie. I would like to recognize the author of the bill, Mr. Price.

Mr. PRICE. Thank you, Madam Chairman. I would like to ask a couple of questions, first, to Ms. Meier. Ms. Meier can you elaborate on exactly what you would have us do with respect to advertising. You have suggested some expansions of the advertising requirements, but I wonder if you could go into more detail at this point.

What are you suggesting that each advertisement of this product should contain, at a minimum?

Ms. MEIER. A lot of what we think are required additions in the advertising area overlap with what in fact the ABA has recommended in its guidelines on advertising to its members. They include disclosure of fees—of all the fees, including title insurance fees, closing costs, etcetera.

They also in their guidelines recommend disclosure of rate cap information. Neither of those two areas of disclosure are currently required under Truth in Lending. We would also like to see in advertisements disclosure of the fact, if applicable, that a balloon payment is required.

And there are some other things that are a bit more technical that we would like to see addressed in the legislation that would undo what has been the interpretation of Truth in Lending by the Federal Reserve Board, vis-a-vis Reg Z.

For example, Reg Z only triggers the additional disclosures that are now required in advertisements if certain conditions are met. And they include a disclosure in the ad of periodic rate, annual rate and a couple other terms. If periodic rate, annual rate or a certain other term is disclosed in the ad, then additional disclosures are required. But, for example, regs right now have a strange dichotomy between affirmative disclosures in the ad and negative or silent disclosures in the ad.

For example, if the ad says you have to pay an annual fee of $10, then that disclosure triggers the additional disclosures, but if the ad says you don't have to pay any annual fee, then the additional disclosures aren't required. We think that that is an anomalous distinction that doesn't make very much sense. We would like to see that eliminated.

A few other aspects of Reg Z we would like to see change by explicit legislation.

Mr. PRICE. But the trigger concept——

Ms. MEIER. We agree with that. We would just like to have it be a little bit more sensible so that any specific term of the program disclosed in the ad would trigger additional disclosures. That would include a few more things than what is now required, but mainly they are limited to what the ABA is now encouraging its members to disclose.

Mr. PRICE. So you have no problem with the aspects of the bill that enlarge the use of that trigger?

Ms. MEIER. No.

Mr. PRICE. But there does seem to be a fairly long list of mandated advertising disclosures that you would want to impose, and I wonder if that would apply to radio ads and billboards also?

Mrs. MEIER. Frankly, I have to say when we developed our recommendations, we were thinking of print media. We would simply have to put our heads together again to address the question of electronic media because we do realize that there are just temporal limitations with that form of media and we did tailor what we thought were important disclosures in the context of the Truth and Savings bill last year according to the form of the media. We certainly think that would be a reasonable approach here so we would be happy to get back to you on that.

Mr. PRICE. So you are not attempting to eliminate or make impossible a billboard advertisement, for example?

Ms. MEIER. No. Let me just say we really have not flushed out the various forms of media. Our recommendations to date have been limited to the assumption that we are dealing with print media, newspaper advertisements, that sort of thing. And I would be happy to get back to you to bring forth our recommendations when you are talking about different forms of media with greater limitations.

Mr. PRICE. It does seem clear, though, that your approach would be to include in the advertisement some of the information that this bill places in disclosures at the time of application.

Ms. MEIER. Well, actually maybe we have a fundamental disagreement there. I think that what we have recommended for advertisement inclusion is minimal. We definitely think that the bill should allow the consumer to rely primarily on the up-front disclosure that will get into all the details and that will include or have with it, accompanying it, the informative brochure. And in fact we were even, before formally responding to the bill, among ourselves saying let's tailor our advertisement recommendations mainly to eliminate misleading and false advertising.

We think we have been very modest in our advertisement recommendations.

Mr. PRICE. But the trigger concept is designed to do that, right? If required periodic payments are mentioned, for example, then you have to go into more detail as to the terms.

Ms. MEIER. That is one aspect in which we have attempted to be modest in our advertising proposal.

Mr. PRICE. But the trigger concept, as I understand it, is designed to prevent one-sided or misleading claims. It is not designed to say such and such has to be in every ad.

Ms. MEIER. Always has to be disclosed, that is correct.

Mr. PRICE. Let me ask you about your index proposals. On page 3 of your testimony, you suggest that lenders be required to base their interest rate charges on an index or other variable out of the control of the lender. Consumers Union has done a very useful survey of the kind of indexes that lenders are now using.

I believe the figures you came up with were that the Wall Street prime was being used by about 58 percent of the lending institutions, the bank's own prime by 16 percent, and other indexes by lesser numbers of institutions. I wonder what the possible alternatives are.

We can readily understand that it is undesirable that a bank be able to apply an index to a home equity loan in isolation. However, isn't there a difference between an index based on a bank's prime rate and one which is arbitrarily set by the bank for home equity loans exclusively?

Ms. MEIER. The objection is that the banks own prime rate isn't something that is externally verifiable. It is a matter of record, in fact, only between the lender and the borrower at prime. In fact, we have had complaints that were somewhat misdirected in coming to our office, but I have heard complaints from small businesses who claimed that banks represented to them that they were getting the prime rate and they found out through the grape vine that another bank got a lower rate. Both borrowers had had it represented to them that they were getting the best, the prime rate. So it is just not something that borrowers can rely on as a rate that will fluctuate with market rate conditions.

And, again, it is not something that borrowers can verify as, in fact, rising internally when it is rising as the index for their home equity loan. They simply can't verify that. They will only be faced with an increased payment amount and rate obligation without having any objective way to verify that the peg rate, in fact, had increased.

Mr. PRICE. Mr. Kirkpatrick, or any of the other banking representatives, I wonder if you can comment on that.

Mr. KIRKPATRICK. Well, Congressman, we believe that the index prime rate that we use, for example, at C&S is posted in the Atlanta Journal Constitution. Whenever there is a fluctuation one way or another, we advise our customers in their periodic statements of any increase in the prime rate.

Mr. PRICE. Could you tell me what you peg your home equity loans to?

Mr. KIRKPATRICK. Ours is pegged to the C&S prime rate which currently is 8.75 percent.

Mr. PRICE. How do you feel about a restriction on the kind of index that you could use with respect to this home equity product?

Mr. KIRKPATRICK. Well——

Mr. PRICE. Do you see any potential for abuse in the completely open-ended system we have right now?

Mr. KIRKPATRICK. Well, I would think Congressman until we are able to see what proposals were made as to what indices would be available to us, it would be hard to answer that right now.

Mr. PRICE. Well, we do have a proposal—I guess the Wall Street prime is your preference, Ms. Meier?

Ms. MEIER. Actually, no. We do not—our recommendation isn't that legislation specify any particular index, but that it generally prohibit use of an index that is not outside the control of the lender. This, in fact, is a requirement of at least one Federal agency's regulations regarding adjustable rate mortgages generally.

So we wouldn't specify the Wall Street prime. We would simply say negatively that a lender can't use an index that is within its own control.

Mr. PRICE. How likely is it, though, that a bank in determining its prime rate—which, of course, serves all sorts of functions and

all sorts of products—how likely is it that this prime rate would be manipulated simply to deal with home equity loans?

That would be my question. Aren't there internal safeguards that would prevent your hypothetical abuses?

Ms. MEIER. I think there is some pressure in that area, but that doesn't eliminate the problem of verifiability. Consumers can't know whether or not the prime rate that is applicable to a totally different class of borrowers has increased when the lender claims in connection with the home equity loan borrower that it has increased.

It doesn't eliminate that problem.

Mr. PRICE. Do any of the banking representatives want to speak to the question of verifiability or about the availability to consumers of information about the prime rate or any other index at a given point in time?

Mr. WOOD. Congressman, in our case we do use the Wall Street Journal prime which is outside of our control. I concur with your point that the prime rate used by a bank serves a multiplicity of functions. If that bank individually moves its [prime] outside of the market range, then they are going to be subject to the movement of a lot of their commercial loans to banks who have a lower rate.

It is my understanding that the Metzenbaum Amendment to the Competitive Equality Banking Act that was recently passed is going to require that all of these adjustable rate loans have a ceiling set on the maximum rate which will take effect on all loans. I believe that this in a sense, will be a way of moving into a verifiable ceiling. This will set the parameters within which the bank can change the rate on their loans. Therefore, if the banks select an arbitrarily high ceiling, outside of the marketplace offering, then it would seem reasonable that they would not draw as many customers to their product as competitors with lower ceilings. I think this has been the case in the first mortgage market where—totally without any regulation, but because of the conditions of sale in the secondary market and market pressures, the banking institutions making first mortgage loans have generally come up with ceilings that are attractive in the marketplace and keep customers coming to them.

In most cases, I think that these range in the 2 percent per year or 5 or 6 percent cap over the life of the loan. It seems to me that in the home equity field market pressures will be coming in the months ahead and will bring about this same kind of control over the maximum price that will be charged for home equity loans, due to the Metzenbaum requirement.

Mr. PRICE. Could you elaborate a little further, Ms. Meier, on the use you are making of the Fannie Mae analogy in terms of rate caps.

Ms. MEIER. Fannie Mae guidelines on the adjustable rate mortgages that it will buy are that they must contain a two point periodic rate cap and a five point lifetime cap.

We are happy to see that they adopted these guidelines and, in fact, it has disciplined the primary market in closed end adjustable rate mortgages toward offering loans that fit those characteristics.

Mr. PRICE. Isn't this undertaken because of the nature of the secondary market? Doesn't this market place a premium on predict-

ability and stability, so there would be trouble marketing these loans otherwise?

Ms. MEIER. I am not sure what you mean. Do you mean just in the standardization?

Mr. PRICE. Yes.

Ms. MEIER. Sure, I agree with that.

Mr. PRICE. No one is assuming that there is going to be a sizeable secondary market in home equity loans.

Ms. MEIER. Right. That is exactly our point, which is that the secondary market because of its requirements of a two point–five point rate cap has then disciplined the primary market to offer loans that fit those requirements so that primary lenders will be free to sell loans either immediately or at some point in time to the secondary market. But without any secondary market in home equity loans, that disciplining effect of the secondary market will not apply to the primary market, the home equity loan market.

In other words, without any secondary market in home equity loans requiring loans with rate caps, you won't have home equity loan lenders dealing directly with consumers trying to conform with guidelines that don't exist, so there won't be that pressure influencing the market.

Mr. PRICE. I don't understand exactly what you are saying about the desirability of a secondary market developing. Are you saying that a secondary market is somehow desirable in home equity loans, per se, or that you would welcome that development simply because it would lead to likely capping of rates?

Ms. MEIER. The latter. I mean, I don't think—at least I don't think it is relevant to this discussion whether or not it would be desirable, per se, to have a secondary market in home equity loans. But if there were one, that adopted the same sort of criteria as the secondary market in closed end ARMs has adopted, that would at least obviate to some extent the need for some legislated rate caps because the secondary market would influence the primary market to react reasonably by incorporating caps.

Mr. PRICE. In the meantime, though lending institutions would be incurring a greater risk with statutory caps because a secondary market does not exist.

Ms. MEIER. Well, our analysis here is the same really as with closed end adjustable rate mortgages. And, in fact, we think it is the thought process or the analysis of the investors in the secondary market in explaining why the secondary market has gone to a five point rate cap requirement. That is, any lender is always going to have to balance rate risk, the risk that rates will increase over the life of the mortgage, with default risk, the risk that if rates increase to such an extent, you will have an increasing number of borrowers who can't make the payments required by that increased rate.

The five point rate cap is a fine balance by lenders between those two forms of risk. There is still enough play of five points for lenders to be able to increase the rate to keep up with increasing borrowing costs, put a cap so that the borrowers will not be suddenly hit with payments that they can't meet and default, thereby putting lenders at risk.

Mr. PRICE. Mr. Abt.

Mr. ABT. Yes, I would like to comment on this Fannie Mae rate cap. I do not think it would be appropriate to have home equity loans controlled in such a fashion. First of all, Fannie Mae's cap on adjustable loans: Adjustable loans represent a very small portion of what they purchase and, for instance, many other lenders around the country offer much more attractive adjustable rate loans than those offered by Fannie Mae.

That is why they don't buy very many. So I don't think we should be looking to that as an example of what should happen in home equity lending.

Mr. PRICE. Well, that was the question I was raising—what does that say, the fact that Fannie Mae has imposed those conditions? It clearly says something clearly about the requirements of the secondary market. But is it logical to take that as a model of what conditions ought to be legislated to protect the consumer on a wider range of products?

Mr. ABT. I don't think so.

Ms. MEIER. But don't you think it says something about Fannie Mae's analysis of the wisest point at which to balance interest rate risk and default risk?

Isn't it arbitrary otherwise?

I mean, wasn't there some motive of lender interest involved there?

Mr. PRICE. Well, I will ask our banking representatives. What would be your account or explanation for what Fannie Mae has done?

Mr. ABT. Obviously, they can set the parameters for what they want to buy in the marketplace, but the fact that they have purchased such a small percentage of adjustable rate loans with those caps suggests that there is something better out in the marketplace that the consumers are buying, and I think, again, here we agree totally—disclosure. Consumers should know exactly what they are getting into and the various aspects of the product.

But in no way should we be dictating to the consumers some artificial standards such as Fannie Mae adopted. It is not pro-consumer.

Mr. PRICE. Mr. Abt, let me turn to you now and ask you to elaborate on a couple of aspects of your testimony. You have some nice words to say about the bill before us, but then you go on to say that your first preference would be for Congress to defer any legislation at this time in light of the Federal Reserve Board's ongoing efforts in this area.

On what grounds do you urge us to defer action?

We have heard testimony today and certainly you are aware of many of the gaps in the current laws disclosure requirements. I think H.R. 3011 is a straightforward way of strengthening the law. First, we are moving the required disclosure to an earlier point in time before the borrower incurs irreversible obligations.

We are also strengthening the advertising requirements by requiring that if you are going to talk about tax deductibility, you must give a more balanced account of what that deductibility actually involves.

And if you are going to talk about periodic payments, then a lending institution must give the full story on rates. Finally we are

saying that there are a number of features in home equity loans that really aren't covered by present disclosure requirements, since they were meant to pertain to credit cards and not to mortgages.

There should be a statement about the risk of one's home. If applicable, there should be a statement that the creditor has the right to change the terms of this loan. If applicable, there should be a statement as to the end result of making interest-only payments.

What on earth is objectionable about those straightforward requirements and why should we defer action until we see what the Fed is going to come up with?

We have some indications of what they are looking at in the proposals they have out for ARMs, and we have considered that in drafting this bill. Congress is now having its say about what those standards ought to be and we are also anticipating difficulties before they arise.

I think we have had some very encouraging testimony that there are not reports of widespread abuses. Why not anticipate problems?

Why not get some sensible disclosure requirements in place?

On what basis do you suggest that we really ought to defer our legislative duties?

Mr. ABT. Well, first of all, I want to commend you for taking the initiative in Congress to look into this.

I think this hearing today in itself is bringing out a lot of ideas that would be really appropriate for the future of home equity lending.

I think our feeling in regards to the Federal Reserve—first of all, they participated in this process today. They said that they were listening very carefully to what was being developed in this hearing.

They are also under the gun to come out with a proposal based on the Competitive Equality Banking Act that was just passed, so there must be some decisions made. They must come forward with these proposals.

Some seem to suggest that possibly based on some past experience they might not come out with the proposals.

We feel strongly the onus is already on them to issue specific proposals in this area and we would want to be sure that there weren't overlapping and conflicting considerations between what might be passed in a bill by Congress and what the Fed is proposing to do anyway. We have no quarrel whatsoever with the direction that this subcommittee is looking into, the direction of disclosure that you are proposing.

We just think it is important that in this process it be clear and understandable, both by those providing the credit and those receiving the credit.

Mr. PRICE. Well, let me just say that we have consulted with the regulators in developing this proposal and certainly we intend to consult closely with them in marking up the bill.

I commend the Fed for what they are doing. I also think, though, that there is ample precedent for rather detailed congressional involvement in setting these standards so it seems to me ideally that this is a cooperative process and there is no reason for Congress to

hold back and wait for this rather protracted process of review by the Federal Reserve to completely run its course.

On another matter: on page 3 of your testimony, you have some brief remarks about the "termination at will" clause, stressing that these kinds of clauses are longstanding features of consumer credit arrangements.

I think for the ordinary consumer these clauses are unsettling. They raise red flags and create a good deal of alarm. So understandably, some are proposing that we should in some way restrict those kinds of clauses.

Could you elaborate on your defense of that kind of provision?

Mr. ABT. I don't think anyone would say a loan that lasted in perpetuity is something that would be reasonable in this world where everything changes, including the borrower's creditworthiness. We are talking here about a credit line that is not necessarily exercised immediately, or all at one time. Years may pass before it is fully exercised, and the lender must be able to evaluate or reevaluate circumstances and the borrower's continuing ability to repay. What if, for example, the secured property were somehow damaged by fire or flood or earthquake? What if the borrower were struck by a personal bankruptcy or other misfortunes? Circumstances change, and the lender must protect against that.

We look at the lending from the savings and loan side as being a long-term business. We are not in this to put a loan on the books today and be out of it tomorrow, so, therefore, we have a responsibility if we are going to be in this business on a long-term basis to be very fair with the consumer and not to do things that are being suggested—could happen arbitrarily.

There is just no evidence that this has happened in the past. We have had loan termination clauses in basic lending agreements for decades and I don't hear anyone commenting on what the problems have been.

But I think our desire is to be in this business, to be a source of credit to homeowners a long time into the future; as we have pointed out—this is the prime lending market in this country.

Two-thirds of the country are homeowners. They are very conservative, they are very responsible people, and we want to be responsible on the other side, and I just don't envision any problems with the termination clause.

If we do, we are going to be out of that business we want to be in long term.

Mr. PRICE. So there are severe market pressures that would make you extremely reluctant to invoke such a clause. You say this kind of clause has been invoked very rarely with other kinds of products. If that is true, and you are so certain of that, why insist on your right to include such clauses?

Mr. ABT. I think just because you can't make—you have to have an agreement that has certain terminations to it. As I said in the beginning, you can't have an agreement that goes on forever. There has to be some point in time when an agreement between a borrower and a lender could be reviewed. Again, I would suggest that the marketplace itself would always prevent a lender from doing anything that certainly would be extremely detrimental to their position in the marketplace, as well as the borrowers.

Mr. PRICE. Ms. Meier, do you have a comment?

Ms. MEIER. I would just like to point out that the standard 30-year mortgage is one that lasts as long as the remaining lifetime of many home equity borrowers. So we already have situations where lenders are willing to commit themselves to fixed terms over a long period of time.

Ms. MEIER. And particularly since we have variable rate features on these loans where lenders are able to continue with a set yield in the face of changing market conditions, that should be enough for lenders to guard against future changes in the market, without having these escape clauses.

Mr. PRICE. Mr. Abt, what kind of termination points do home equity loans now typically have? What is the common practice?

Mr. ABT. We grant our home equity loans for a 15-year term. The line of credit is outstanding for the entire 15 years. There is a clause in the contract that allows a termination at the end of 5 years.

But we have no intention of calling loans in 5 years. We fully are granting a full 15-year line of credit to the customer.

Mr. PRICE. And that termination point is considerably short of what is found in most first mortgages?

Mr. ABT. Well, I think if we reflect back on the second mortgage environment that we were talking about earlier, I think a high percentage of the loans that were granted for 15 and 20 years over, let's say, the past 10 to 15 years, did have a 5-year call provision. That was a call provision in the second mortgage type lending that has been on the books.

Mr. PRICE. Thank you. I wonder if we could turn briefly to Mr. Kirkpatrick. We are rushing here, but I would like to ask you a couple of questions that will, I think, help us in our subsequent work on this legislation.

I particularly want to ask you to elaborate on your testimony on page 5 regarding the deadline that lending institutions face in making full disclosure. As you know, the Federal Reserve's current proposal on adjustable rate mortgages also requires earlier disclosure. The standard it sets, I believe, is: when the application is furnished to the prospective lender or when a non-refundable fee is paid, whichever comes sooner. That, I believe, is the standard that is out for review now with respect to adjustable rate mortgages in general.

Is that a standard that you find unrealistic or objectionable?

Mr. KIRKPATRICK. No, Congressman, not unrealistic. We just believe with the change in fees and the determination of the line amount that it is necessary for us to make, sometimes the application process, when the borrower first comes in, we may not be readily able to determine at that point the appropriate fees that are going to be charged and we would just like to have sufficient time to prepare and mail to the borrower within 3 days the correct fees based on the line requested or what line we feel we can grant, or if there is still some question at the end of 3 days, waiting for the appraisal or the credit qualifications to determine the line amount, in such cases such as taxable income to provide those—at least provide the borrower how those fees are determined so they will know.

Mr. PRICE. Do the objections that you have raised here today apply equally to that Federal Reserve proposed standard?

What I am getting at is this. Are there good reasons to pose different requirements for home equity loans than what we pose for adjustable rate mortgages in general?

Mr. KIRKPATRICK. The reason the testimony has tried to allow for 3 days is that right of rescission utilizes a 3-day business period and disclosure requirements currently on first mortgage loans provided 3 days for disseminating information to the borrower also. The ABA was trying to get a consistency there with 3 days.

Mr. PRICE. All right. This, of course, gets into some technical matters that we will need to discuss with you as we develop the final draft. But in general, you do approve of the idea of earlier disclosure and, in particular, of disclosing terms to prospective borrowers before obligations are irreversibly incurred?

Mr. KIRKPATRICK. Yes, sir. The ABA supports that fully in your bill and we believe that an informed borrower is a banker's best ally.

Mr. PRICE. Madam Chairman, I have one further question. It has to do with preemption of State laws. I would like to turn to Mr. Pohl here because I think his testimony deals most extensively with that. You talk about State disclosure requirements affecting almost every phase of home equity loan transactions. I wonder if you could elaborate on that, or if any of the other witnesses could, for that matter. Does anyone have systematic evidence as to the extent of State regulation in this area already and what your experience has been with it?

Mr. POHL. Thank you, Congressman Price. The statement with regard to State disclosure laws was alluding to legislation that existed in a number of States which does effect lending transactions which are open-ended in nature and typically those State laws will require a specific breakdown, as disclosure of the relevant terms of the lending transaction. From that standpoint, we feel that there already is existing legislation in place which addresses the topic.

As far as that legislation preempting anything which might be undertaken through your proposed bill, obviously that would be something we would point out just as a point of avoiding conflict to provide lenders and consumers with some certainty as they go forward in these transactions.

Mr. PRICE. Do any of the witnesses have specific experience with State law, or any generalizations you could make about action underway in the States and what your institution's experience has been with State regulation of these loans? Ms. Meier?

Ms. MEIER. I haven't looked into this. I don't know.

Mr. PRICE. How does your organization feel about the preemption of State laws?

Ms. MEIER. Generally we are very wary to preempt State laws, particularly if the preemption would not have an exception in the case of laws that better protect the consumer. For example, in the check holding legislation that recently was enacted, we strongly supported allowing State check hold laws that had time schedules that were shorter than the Federal legislation to remain on the books even after passage of the legislation. We believe generally that consumers, whether it be by State law or Federal law, should

be protected as strongly as possible. We would be very reluctant if there were a preemption provision.

Mr. PRICE. Do the rest of you defend State preemption? Anyone wish to respond?

Mr. ABT. We would favor Federal preemption.

Mr. PRICE. I mean Federal preemption. Any particular reason that it is important in the case of this legislation?

Mr. ABT. Well, I think it is important for uniformity. We have a marketplace that is more than just nationwide today. It is worldwide. But I mean, I think, dealing with disclosure on home equity loans would be appropriately dealt with, the same terms, the same conditions on a nationwide basis.

Mr. PRICE. That obviously is an issue we are going to have to deal with as we approach markup. Madam Chairman, I have imposed on your patience. I appreciate the chance to question the witnesses fully. I appreciate also the fine testimony we have heard today and the responsiveness of all of our witnesses to the questions that I and other subcommittee Members have had.

Ms. PELOSI. Thank you, Mr. Price. If you have any further questions, would our witnesses be available to receive questions in writing? I know this subcommittee may have other questions for Ms. Meier and for the gentlemen representing the financial institutions.

As you know, consumer protection is very important to the work of this subcommittee, to our full committee and, of course, to the Congress of the United States. Consumer debt is a problem which we are facing. Mr. Price's legislation gives us an opportunity to discuss a disclosure of the mechanics of protecting the consumer from getting in over his or her head. It also gives us a chance to discuss some of the caps, the arms, and the other parts of the body of a lender. Some of our questions will relate to issues which will be helpful to us in further deliberations of this subcommittee and also of the full banking committee.

I want to thank the witnesses for their testimony today and ask them if they have any further statements they would like to make in closing, in light of Mr. Price's questions? You may be receiving some questions from us in writing. Thank you again for being here today and for your testimony. The meeting is adjourned.

[Whereupon, at 12:55 p.m., the subcommittee was adjourned.]

APPENDIX

STATEMENT OF THE HONORABLE NANCY PELOSI
ON THE HEARING FOR H.R. 3011
THE HOME EQUITY LOAN CONSUMER PROTECTION ACT OF 1987
OCTOBER 6, 1987

MR. CHAIRMAN: I AM PLEASED TO PARTICIPATE IN THIS HEARING FOR H.R. 3011, AN IMPORTANT PIECE OF LEGISLATION OF WHICH I AM A COSPONSOR. ONE OF THE SIGNIFICANT ROLES THIS SUBCOMMITTEE PLAYS IS ONE OF CONSUMER PROTECTION. H.R. 3011 IS A STRONG PIECE OF CONSUMER PROTECTION LEGISLATION WHICH MERITS OUR ATTENTION.

HOME EQUITY LOANS ARE RAPIDLY BECOMING A POPULAR FORM OF BORROWING. IN MANY CASES, HOWEVER, IT IS UNFORTUNATE THAT THE CONSUMER INTERESTED IN SUCH A LOAN HAS NO CLEAR IDEA OF THE CONDITIONS OR THE ULTIMATE COSTS OF SUCH A LOAN. H.R. 3011 WOULD ENSURE THAT CONSUMERS ARE GIVEN THE OPPORTUNITY TO COMPARE LOAN TERMS OFFERED BY DIFFERENT LENDING INSTITUTIONS, AND AT THE SAME TIME, ENSURES THAT CONSUMERS ARE ABLE TO SEE READILY THE POTENTIAL IMPACT OF INTEREST RATE INCREASES ON MONTHLY PAYMENTS.

TESTIFYING HERE TODAY IS A RANGE OF WITNESSES REPRESENTING CONSUMER GROUPS, AS WELL AS FINANCIAL INSTITUTIONS. I LOOK FORWARD TO THEIR TESTIMONY AS TO THE IMPACT OF H.R. 3011 ON THE GROUPS AND INTERESTS THEY REPRESENT. THANK YOU.

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Testimony of Congressman David E. Price
Before the House Subcommittee on Consumer Affairs and Coinage
At Hearings On
H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987
October 6, 1987

Chairman Annunzio, and members of the Subcommittee, I appreciate the opportunity to appear before you today. I am grateful to you for scheduling hearings so promptly on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987.

Home Equity loans have become the latest financial craze. Much of the increasing popularity of these loans is due to the Tax Reform Act of 1986 which phased out the deductibility of interest on other consumer loans while leaving it in place for loans secured by one's home.

Banks have marketed this product heavily, and I have brought four examples of these advertisements with me today. As you can see, each of these ads prominently displays one feature of these loans --- a low interest rate, or a discount on settlement fees, or fixed monthly payments. As a consequence, a consumer is faced with a dazzling array of possible loan terms and conditions.

Unfortunately, under current law, that consumer may never be advised about the essential features of his or her home equity loan until it's time to sign the final agreement. Currently, under Regulation Z, a comprehensive set of disclosures is only provided when credit is extended to the borrower. While these disclosures are necessary, they fail to give consumers key information at a time when it would be useful for comparing products at different institutions. Furthermore, a consumer may have already paid a nonrefundable fee and never seen important provisions of the loan.

H.R. 3011 will help the consumer place these loan options in perspective. Regardless of what first interested a consumer in home equity loans, H.R. 3011 will require that at the time of application a consumer will be given a series of key disclosures which will enable him or her to make a sound judgement about these loans.

These upfront disclosures are designed to give consumers information in two critical areas. First, the disclosures will give a consumer the ability to evaluate whether a home equity loans is the best financial option for them. This is crucial for any product which potentially places one's home at risk.

Secondly, if the consumer decides to go ahead and take out the loan, H.R. 3011 will give the consumer vital information with which to compare home equity products offered by various institutions.

H.R. 3011 will ensure that disclosures about the interest rate and fees are given to consumers at an early date. The bill also requires a financial institution to disclose whether its loan product has annual and lifetime caps on interest rates, and to present an example which will let consumer see the potential impact of a rise in interest rates on their monthly payments. These early disclosures will also include a series of statements about features of the loans, like interest-only payments, which may have drawbacks for certain consumers. Finally, the Federal Reserve will be required to develop a pamphlet which will be furnished to prospective borrowers. This pamphlet will give detailed information about home equity loans and discuss their relative advantages and disadvantages.

My concern with the timing of the disclosures is consistent with the Federal Reserve Board's proposed changes to Regulation Z (Truth-in-Lending) regarding closed-end adjustable rate mortgages (ARMs). The most significant change to Regulation Z would be the requirement that more information be given to consumers about ARMs at the time of application.

I believe there are good reasons to develop parallel requirements for home equity loans. This treatment makes sense since basically home equity loans are second mortgages. The main difference is that home equity loans are an open line of credit whereas most traditional mortgage products are closed end lines of credit. This difference allows consumers to borrow and repay against their home equity line as needed rather than receiving a fixed lump sum at one point in time.

However, the difference between ARMs and home equity loans should not obscure the necessity, in both cases, of informing consumers early on about the risk to their homes and the terms and conditions of the loan. This emphasis on early and complete disclosure of key loan conditions is the essence of H.R. 3011.

H.R. 3011 also recognizes that there have been some problems in the advertising of home equity loans, and I have included some provisions to remedy them. For instance, an advertisement, like American Security Bank's, which features a monthly payment amount, would currently not be required under Regulation Z to reveal such terms of the loan like the annual percentage rate, which is now incompletely disclosed in the fine print of the ad. My bill will ensure that any periodic payment amount mentioned in an ad requires additional disclosures on the part of the lender.

The bill also outlaws misleading terms like free money which

consumer groups have pointed to as being used in ads. And, it requires any advertisement which mentions the tax deductibility feature of these loans to also clearly and conspicuously state that such interest expense may not be completely deductible for all taxpayers.

In formulating this bill, I have discussed and considered proposals from both consumer and industry groups. This legislation has grown out of these discussions, and the result is a bill stronger for the consumers and more workable for financial institutions. I look forward to working with subcommittee members as they proceed with further consideration of the bill.

I do, however, want to take this opportunity to discuss an area where I believe no change should take place. I am opposed to any change which would mandate restrictive requirements like a specific annual or lifetime cap on these loans.

This would be a mistake because it would not be keeping with the intent of this legislation. This legislation is designed to bring home equity loans up to the same standards as other mortgage products. It should not place burdens on these loans which do not apply to other loans.

I also believe with regard to caps on home equity loans, the Congress has recently expressed its opinion. The Competitive Equality Act of 1987 requires a creditor to establish a lifetime cap of their choosing on the interest rate of a home equity loan.

But most importantly, I am concerned about the impact of a cap on other customers of the banks, particularly low and moderate income consumers. Home equity loans are mainly a middle class and upper class phenomena. Data from the University of Michigan's Survey Research Center have shown that home equity borrowers have a higher median income and education than home owners generally.

If home equity loans were capped -- as "protection" for middle and upper income borrowers -- institutions could be forced to shift costs to other customers -- many of them low-income borrowers who need a car loan or similar financial assistance. Variable rate loans represent a contract between the bank and the customer. The customer receives lower rates than on a comparable fixed rate loan in exchange for taking on the risk of possibly higher rates in the future. My bill is designed to ensure that a consumer is fully informed about the risk and benefits of these loans but will not encourage cost-shifting by restricting home equity loans more than other loan instruments.

I favor a good strong disclosure bill because it will help the home equity borrower without harming the other customers of the bank.

Finally, I believe there is ample proof that our colleagues on the Banking Committee, and throughout the House agree with the approach embodied in H.R. 3011. Currently, I have 52 cosponsors of my legislation including 24 other members of the Banking Committee. It is a bipartisan group of sponsors, and with your help we have a real chance to move quickly and put in place a disclosure bill of real benefit to the consumer.

I am grateful for the support I have received, and I look forward to continuing to work on this legislation with this subcommittee and other interested parties.

Thank you, and I would be happy to respond to questions from my colleagues.

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Testimony of Congressman Charles E. Schumer

Before the House Subcommittee on Consumer Affairs and Coinage

At Hearings On

H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987

October 6, 1987

I want to begin this morning by thanking Chairman Annunzio for holding this important hearing on Home Equity Loans and for inviting me to testify. As usual, Chairman Annunzio is at the forefront of this consumer banking issue.

I would also thank Congressman Price for his leadership on this issue. Mr. Price has shown in his short time in Congress to be a great ally of consumers in his Banking Committee duties. It has been a pleasure working with him.

Mr. Chairman, at a time when consumer debt has risen to record levels, we are seeing yet another hot banking product that could put many consumers over the brink. This new product is called the Home Equity Loan. Banks have been pushing them with all their advertising dollars and consumers are lining up to apply for them. But Home Equity Loans have several potential pitfalls if a consumer is not completely aware what they are buying. That is why these hearings are so important and that is why Congressman Price's legislation is so important.

The biggest problem is something that I would call "Rate Rise Surprise". Too few consumers are aware that many Home Equity Loans have a variable interest rate that has no ceiling. Most of these loans carry an interest rate that is tied to an index. The problem is that the index is often very high. Even worse is that some banks use an index that is in control of the bank board and thus not necessarily based on the true cost of money.

For example, Barclays Bank of New York offers a Home Equity Loan that has a variable rate but has no publicly available index. The index is determined by the board of the bank. Since Barclays has no rate cap, the interest rate can potentially rise out of sight even if the cost of money has not increased.

The problem of rate rise surprise is made even worse by the advertisement of superlow "teaser" rates that only apply for the first few months of the loan.

Another potential pitfall of the Home Equity Loan is "Balloon Crunch". Many banks offer temptingly low interest rates and payment schedules at the beginning of the loan only to slam the consumer with one lump payment in some later year.

American Security Bank of Washington and Manufacturer's Hanover Trust of New York offer Home Equity Loans that allow for interest-only payments on the loan for the first ten years of the loan. After ten years the <u>entire</u> amount of the loan is due in one lump payment.

In a particularly bad case, The Bank of Contra Costa in San Francisco offers a Home Equity Loan that allows the consumer to pay only 1.5% of the balance for five years and then requires a balloon payment of the entire amount of the loan. And the minimum line they extend is $25,000. So the final payment could sink almost any family.

Perhaps the most troubling trend in the marketing of Home Equity Loans is that the consumer is rarely given the whole picture in advertisements and solicitations for the product.

Although many ads for Home Equity Loans tout the supposed tax deductibility of the loans and they scream about the loans being "free money", there are often key facts that the banks don't advertise.

Citizens Savings Bank in Washington has run ads that go to great lengths to advertise that its interest rate is fixed for three years. What the ad does not say is that after 15 years the loan results in a balloon payment.

The Bank of the West in California loves to advertise all the great things that a Home Equity Loan can provide money for, but it makes no mention of its interest rate, its index or its big balloon payment.

Congressman Price's legislation goes a long way toward dealing with the major problems I outlined. It clarifies that Home Equity Loans are subject to the same disclosure requirements under the Truth in Lending Act that other mortgage instruments are.

The Price legislation takes the important steps to ensure that the rate of interest and how that rate is calculated or adjusted in the future, are all clearly disclosed to the consumer at the time of application.

The Price bill also mandates that certain warnings be given to the consumer before they take out the loan. These warnings about the danger of interest only payments, potential home loss and the potential interest rate increase, are all necessary to give borrowers the whole story before they borrow.

There are, however, areas of consumer protection where I would go even further than Congressman Price. I agree with Mr. Price, that the main thrust of any Home Equity Loan legislation should be disclosure. In addition to the strong provisions already contained in the Price bill, I feel it is important to disclose the index, the timing and nature of future rate changes, any annual fees and other payment terms in the <u>advertisements</u> for the loan. I would also require that the possibility of a huge balloon payment be disclosed.

Clear disclosure of these items in ads will allow potential borrowers to comparison shop much easier and it will also put a chill on the many deceptive ads we have seen.

I would also make it illegal for any bank to be in control of the index that will be used to calculate the changes in the interest rate. If the interest rate on a Home Equity Loan is going to be variable, then it should be a publicly available index, not some arbitrary number that is changed at the whim of the bank.

To further protect the borrower, I would make interest only payments on Home Equity Loans illegal. Interest only payments, ones that retire no principal, have the advantage of allowing for very low monthly payments. The problem is that if a percentage of the principal is not paid off as the loan matures, the payments in the closing years can be devastating and a family can lose their home. Home Equity Loans should be repaid in a way that allows them to be fully paid off over a fixed term.

I would also add a provision that would outlaw what I call "Surprise Balloon Payments". Surprise Balloon Payments occur when a lender decides that they want to close out a Home Equity Loan, so they call in the outstanding balance. Often lenders reserve this right in the contract. As I mentioned above, the possibility of a balloon payment should be clearly outlined in the advertisement, the application and the contract. I would also make it illegal to call in the loan before it has matured, unless the borrower has been delinquent.

Finally, I would like to see a annual cap on the amount that the interest rate on a Home Equity Loan may increase. An annual cap of 2%, the amount used by Fannie Mae, would be correct. The cap would protect the consumer from huge swings in interest rates, while allowing lenders to make a substantial profit on the loan.

These changes that I would make should not overshadow the basic consensus that exists on the subject of Home Equity Loans. There is a feeling in Congress, that consumers are being led into the Home Equity Loan market without enough information and protection. There is agreement that the advertising of this hot new banking product has often been deceptive and sometimes outrageous.

I hope that the this subcommittee will continue to give careful consideration to these still emerging problems. Given the past record of you, Chairman Annunzio, I am sure that will happen.

Thank you again for the opportunity to testify before you this morning.

For Release on Delivery
10:00 A.M., EDT
October 6, 1987

Statement by

Martha R. Seger

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs and Coinage

of the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

October 6, 1987

I appreciate the opportunity to appear before this subcommittee to discuss home equity lines of credit and H.R. 3011. The proposed bill would amend the Truth in Lending Act to require creditors to provide consumers with more information about home equity programs in advertisements and in initial account disclosure statements.

The information that we have regarding home equity lines of credit shows that there has been a substantial growth in this type of credit since 1984, with outstanding balances totaling approximately $40 billion at the end of 1986. We believe that the total may now be as high as $65 billion and could reach $75 to $80 billion by year-end.

This rapid expansion is probably attributable to several factors. For example, the plans have provided consumers convenient access to credit at interest rates that are relatively low compared to other means of financing consumer spending. Tax laws phasing out the deductibility of interest for nonmortgage consumer debt have made home equity loans more desirable to tax conscious borrowers. In addition, competition among financial institutions to offer diverse financial services to their customers has resulted in vigorous marketing of home equity lines, often at low introductory interest rates and discounted fees.

Recently, the Board and other bank regulatory agencies changed the reporting requirements for credit secured by real estate to provide more complete and accurate information on

household borrowing through home equity lines of credit. This change should provide more accurate information for an important segment of the market, and enable us to better gauge the growth of this type of credit and the effect it is having on other consumer borrowing. In addition, the Board has conducted consumer surveys this year to gather information that will allow us to better understand consumer usage of home equity lines of credit.

During the past year, the Board has received inquiries from financial institutions, trade associations, consumer groups, and the Congress concerning home equity lines of credit. Much of the debate has focused on the current disclosure requirements for these loans, and whether these requirements are adequate. The sponsors of H.R. 3011 have sought to address some of these concerns by introducing legislation to require additional disclosures for home equity loans. At the same time, the Board has been reviewing its current regulatory requirements, with the goal of ensuring that consumers receive sufficient information prior to contracting for this type of credit.

Legislative Proposal

H.R. 3011 would amend the Truth in Lending Act to establish additional disclosure and advertising requirements for open-end credit plans secured by the consumer's dwelling. Currently, the Truth in Lending Act and Regulation Z treat home equity lines of credit like other types of open-end credit plans.

As a result, creditors are required to disclose how the finance charge will be determined under the plan, what other charges will be imposed, the security interest being taken, and the consumer's billing rights.

The proposed bill would require creditors to give more extensive and detailed disclosures. For example, it would require more disclosures concerning the annual percentage rate, including, if applicable, a statement that no limit on annual rate increases exists. The bill would also add an example, based on a $10,000 amount outstanding, showing the payment terms under the plan and how changes in the annual percentage rate could affect payments under the plan. In addition, the proposed bill would call for disclosure of the creditor's ability to unilaterally change the terms and conditions of the plan, a statement that the consumer risks losing his or her home in the event of any default, and a disclosure that interest-only payments increase the cost of the loan since they do not reduce the principal owed. Creditors would also be required to give consumers a pamphlet that is to be prepared by the Board. These additional disclosures would generally have to be given at the time of application, which is earlier than current requirements, and would have to be segregated from other information, which is once again a departure from current Truth in Lending requirements for open-end credit.

The proposed legislation would also add a new advertising section to the Truth in Lending Act for home equity

lines. Currently, a creditor is required to make certain cost disclosures in advertisements only when "any specific terms of the plan" are included in the advertisement. Regulation Z limits "specific terms" to items that are required to be disclosed in the initial disclosures. The bill would add a reference to a periodic payment amount as a term that requires the advertisement to include additional disclosures. The bill also would require, under certain circumstances, a disclosure regarding the tax-deductibility of interest paid on home equity lines, and would prohibit creditors from referring to home equity loans as "free money" or a "loan at prime."

Possible Regulatory Action

Since home equity programs are more complex than other types of open-end credit plans, and pose a greater risk to consumers if they fail to understand the terms and conditions of the plan, the Board, like the Congress, is concerned about whether the existing disclosure requirements under the Truth in Lending Act and Regulation Z ensure that consumers receive adequate information about these types of loans when they contract for a particular plan. In our review of H.R. 3011, we find that the Congress has identified many of the issues that we ourselves have targeted as major areas of concern that possibly could be addressed through regulatory action.

During the past year, Board staff has been considering the issue of home equity lending within the context of Truth in

Lending disclosure requirements. In addition, the Board's Consumer Advisory Council formed a subcommittee at the beginning of this year to look into the issue and has discussed it at its past two meetings. The staff's analysis indicates that the current regulatory requirements for open-end credit may not adequately reflect the complexities that are present in most home equity programs. Specifically, the staff has focused on the content, timing, and format of the disclosures required under Regulation Z as possible candidates for regulatory change. At this time, Board staff is preparing a proposal that would amend Regulation Z to address these issues and expects to present their recommendations to the Board sometime next month. Although the review is still in process, and neither the staff nor the Board has made any firm decisions about what can and should be done, I would like to share with you some of the particular issues we have been considering.

Under current requirements, when a home equity plan is opened, a creditor need only give those general disclosures that I previously outlined. Creditors are not required to disclose certain items, such as their right to unilaterally change the terms and conditions of the plan, or the possibility that a balloon payment may be required as part of the plan. It is conceivable that Regulation Z could be amended to require disclosure of these features. There also may be a need to require more disclosures in home equity line advertisements. Some questions raised in this regard include whether "teaser"

rates are adequately disclosed as only lasting for a limited time period and whether disclosing a payment term in an advertisement should require disclosure of other material terms, such as the annual percentage rate or fees to be charged under the plan. In considering any additional disclosure requirements, however, the Board is guided by the principle that disclosures should provide consumers with essential information, without overloading them with less important information or unnecessarily raising creditors' compliance costs.

Another area we have identified as one to look into concerns the timing of disclosures. Regulation Z currently permits open-end credit disclosures to be given anytime prior to the first transaction. In the case of home equity lines of credit, therefore, consumers, in many cases, do not receive disclosures about the terms and conditions of the plan until closing. Since most home equity credit plans involve large up-front fees and tend to be more complex than other types of open-end credit, an argument can be made for requiring disclosure of the fees, terms, and conditions of such plans at an earlier time in the credit process.

Finally, concern has been expressed that consumers may not fully understand the terms and conditions of the programs. This concern may be due, in part, to the complexity of these plans and the fact that the underlying contracts could run several pages in length. Currently, Regulation Z does not require any special format for open-end disclosures. As a

result, in most cases, the disclosures given for these plans are not segregated from the contractual provisions or highlighted in any standard manner. We believe that consumers should be alerted to the most important terms and conditions of the plans for which they contract. To the extent that the current regulatory requirements fail to meet this goal, it might be necessary to require that disclosures about these plans be segregated from other information.

The Federal Reserve Board shares the goal that consumers receive adequate information at a relevant stage of the credit process when they contract for home equity loans. We believe that it is particularly important that consumers understand these programs since they arguably pose a greater risk because of their complexity, the large credit lines generally involved, and the possibility of losing one's home. Therefore, we look forward to working with you on this important subject.

STATEMENT OF
THE CONSUMER BANKERS ASSOCIATION
BEFORE THE
CONSUMER AFFAIRS AND COINAGE SUBCOMMITTEE
OF THE
HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

October 6, 1987

Consumer Bankers Association (CBA)* appreciates the opportunity to make a statement on H.R. 3011 and the subject of home equity lending generally.

The CBA position is a very simple one. Home equity loans and lines of credit are proving to be among the most popular and useful financial products in a generation. They afford consumers financial liquidity and flexibility never before possible. Available evidence indicates that consumers are using them prudently. Home equity credit is already subject to significant regulation, both as to disclosure and as to terms and practices and further regulatory proposals are being considered at the Federal Reserve Board.

Our view, therefore, is that overly restrictive new legislation on home equity credit is unneeded. At best, congressional consideration should be limited to minor modifications of the existing disclosure scheme, such as are proposed in H.R 3011 introduced by Congressman David Price of North Carolina. Even here, the staff of the Federal Reserve Board is already developing a parallel package of recommendations on this subject that may render congressional efforts premature and duplicative. In any event, our testimony will show that present circumstances warrant nothing more than the earlier disclosure of essential credit shopping information.

I. Erroneous Presumptions Must Be Laid to Rest

Initiatives to impose substantive restraints on home equity lending practices are based on a number of erroneous presumptions. These range from misunderstandings of the nature of open-end lending practices in general and home equity loans in particular, to outright mistakes and mischaracterizations concerning the applicability of existing state and federal disclosure and consumer protection laws.

They also evidence a pervasive bias that must be laid to rest immediately. That is the notion that home equity borrowers and lenders together are bent on rushing blindly and even irresponsibly toward the brink of financial ruin. This notion is totally unsupportable when one reviews current consumer usage patterns, delinquency and default rates, and industry credit granting standards and practices, educational efforts and foreclosure experiences.

It is important to focus on the essence of the home equity line of credit (HELC) relationship. Consumers, already involved in purchase money mortgage financing, gain further access to their own assets. Lenders, having identified the characteristics of stability and maturity that define the ideal lending risk and the core of a desirable customer base, commit to honor substantial credit requests at favorable interest rates on an extended, open-ended basis. This relationship is consummated only after the lender gives detailed contractual disclosures and only after the consumer declines to cancel the deal during a three-day cooling-off period provided by federal law. In short, this is a popular, pro-consumer financial service entered into with foreknowledge

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* The Consumer Bankers Association was founded in 1919 to provide a progressive voice for the retail banking industry. CBA represents approximately 700 federally insured banks, savings and loans and credit unions that hold more than 80 percent of all consumer deposits, and more than 70 percent of all consumer credit held by federally insured depository institutions.

and deliberation by a financially experienced borrowing public.

The demographic profile of this HELC service underscores these points. During the spring of 1987, the Survey Research Center (SRC) of the University of Michigan studied the subject on behalf of the Division of Research and Statistics of the Board of Governors of the Federal Reserve System. In the summer of 1987, the Center for Financial Services Studies of the McIntire School of Commerce the University of Virginia conducted a vastly more detailed survey on the subject on behalf of CBA covering 302 financial institutions in 47 states. The results of each survey are strikingly similar where comparable questions were asked. Survey results are parenthetically referenced below by descriptive initials (i.e., SRC or CBA).

The average consumer borrower is between 35 and 49 years of age (CBA). The borrower's household income equals or exceeds $44,000 (CBA/SRC) That borrower has worked for the same employer for 8 years, owned a home for over 9 (CBA), and tends to be better educated than the average homeowner (SRC). Less than 10% of the households surveyed by SRC had either applied for or held a HELC. Finally, of the 80% of homeowners surveyed who acknowledged their availability, nine-tenths indicated no intention of opening a home equity credit line in the near future (SRC).

The maturity and deliberation of the borrowing public is further reflected in HELC usage patterns. The most frequently mentioned reason for borrowing was for home improvements (CBA/SRC). Debt consolidation was the second mos frequently mentioned reason (CBA/SRC). About 5% of the financial institutions cited major purchases, personal investments or educational expenses as the most frequent usages of borrowed funds (CBA). Finally, 31% of HELC borrowers indicated no account usage to date, more than half reported no use in the preceding six months and one-fifth had used their accounts just once (SRC).

Creditors surveyed substanti ted this sobriety in usage patterns. The average creditor held $11,800,000 in approved lines but only $6,800,000 in actual HELC outstandings (CBA). Only one-fifth of all home equity borrowers surveyed indicated that they had used more than half of their credit line (SRC). Creditors offering variable rate HELCs ndicate that their typical borrower has drawn down no more than 57% of the available credit line (CBA).

The deliberation and prudence with wh ch borrowers approach HELC borrowing is matched by that of creditors granting those privileges While the maximum loan-to-value ratio used by the average creditor is 76%, the average variable rate HELC is granted at a loan-to-value factor of less than 70% (CBA). In fact, this conservative rati inc udes both first mortgage debt and the approved HELC (CBA). Further, if you look only at present outstandings (as opposed to approved HELCs), this factor shrinks to only 57% (CBA)! The effective result of these factors is that the average variable rate HELC equals less than 1/2 of the tota home equity of the average homeowner (CBA).* We also note that over 70% of variable rate HELC approvals are based either on a fu appraisa or munici pa tax assessment (CBA). Finally, most creditors reported strict cred t review procedures on at least an annual periodic basis after opening a HELC relationship (CBA).

Ultimately, the care and conservatism with which borrowers approach HELC usage and creditors address HELC lending is nowhere better reflected than in the ow rates of HELC delinquency and foreclosure. The rate of HEL de inquencies more than 30% ess than that of all consumer credit (CBA). About 1% of all HELCs were de nquent (over 30 days) in 1986, as compared to 1.5% of all consumer debt other than unsecured credit cards) (CBA). Inclusion of credit card delinquencies would expand this differential appreciably. Also, only 14 of the 302 institutions surveyed reported any foreclosures in 1986! This represented approximately 1.5 foreclosures per reporting institution.

* The appraised value of the average house was $84,975, and the outstanding balance on the first mortgage was $34,989, leaving average total available equity of $49,986 (CBA).

This evidence suggests that consumers and creditors are treating the HELC relationship with the utmost respect and caution Neither homeowners nor creditors are profligate with respect to the usage or provision of this consumer financia service. Substantive restrictions to protect homeowners from an alleged propens ty for irresponsible behavior, whether their own or that attributed to the financial institutions with which they deal, are neither necessary or justifiable. No patterns of abuse can be documented at this time nor does the evidence suggest that they will be in the future.

In fact, in addition to prudent lending practices, HELC providers have taken a further pro-consumer stance by providing marketing and educational guidelines to both their financial services co leagues and to consumers generally. HELC advertising guidelines have ircu ated at the state and national trade association levels. Consumer education pamphlets and shopping guides have been produced and dissem nated nationwide.

CBA itself has produced a consumer pamphlet for it members to use. It has met with unparalleled demand (an excerpt is attached as Appendix A). To date, CBA has given severa thousand copies of the brochure directly to consumers across the country, pursuant to requests generated by related publicity. In addition, CBA has issued approximately 100,000 copies to its members as a customer relations tool. CBA has also made camera-ready copies available to more than dozen members for in-house reproduction and d semination. One such CBA member plans public distribution of 50,000 customized pamphlets.

The pro-active efforts underscore the industry's commitment to the responsible and informed usage of HELCs. These efforts refute directly consumerist charges of reckless promotions centering on inducements to luxury or frivolous expenditures.

Similarly, they refute related charges of insufficient HELC disclosure and shopping information. Consumers simply have not found there to be a lack of HELC information in the marketplace More than 90% of the HELC account holders interviewed by SRC reported that they had received a of the information they needed before they opened their HELC. More than 35% of those account holders said that they had considered an a ternative source of credit a clear ndicator of compar son shopping capability and one that accords with Federa Reserve studies of actual credit shopping experience for <u>all</u> forms of consumer credit.*

Based on the analyses of consumer usage patterns, delinquency and default rates, and industry credit granting practices and educational efforts, we submit that there is simply no evidence of need for the imposition of substantive restrictions on HELC practices.

II. <u>There is a Wealth of Existing Disclosure Law and Consumer Protections</u>

It is equally erroneous to assume or assert that home equity credit is a marketplace out aw, nd that consumers are subject to un imited deception and abuse in such transactions The fact is that a whole array of federal and state consumer protection laws applies to home equity credit and there is movement to fine-tune those laws to deal with the emerging patterns of HELCs.

Let us review briefly the major existing constraints, to show how much discipline already exists in the home equity credit market.

A. Just this past July, Congress mandated -- in Section 1204 of the Competitive Equality Banking Act of 1987 (P.L. 100-86) that creditors must include interest rate caps in all adjustable-rate, dwelling-secured consumer credit transactions. This includes conventional closed-end second mortgages, as well as the more recent pattern of HELCs secured by the consumer's home.

* For example, see the <u>Annual Percentage Rate Demonstration Project</u>, Board of Governors of the Federal Reserve System, March 1987, p. 29.

In its proposed regulations to implement that law (52 FR 34811, September 15, 1987), the Federal Reserve Board has taken a broad view of the legislative intent. For example the proposal covers transactions with "termination" clauses (i.e. the creditor's right to ca[ll] or accelerate, the entire loan balance), as we[ll] as transactions with expl[i]cit rate adjustment features[.] Thus one suggested weakness of home equity credit[—]the absence of contractual rate limitations -- will soon disappear. And if creditors now must include rate caps in the contract, they can be expected to compete for customers by offering more favorable limitations.

B. The federal Truth in Lending Act (TILA)* contains a time-proven regimen for advertising about home equity credit. That Act also requires detailed sets of transactional disclosures that reflect the d[i]fferences between closed-end and open-end credit formats and between variable-rate and fixed rate terms. In open-end transactions in particular, consumers receive disclosures before the account is opened, and periodic reminders of the status of the account, balances owing, payments due, and app[l]icable rates and terms. The TILA initial disc[l]osures must include "c[l]ear and conspicuous references to any security interest and to the property serv[i]ng as collateral. The chart attached as Appendix B details all of these disclosure requirements.

Not only do home equity credit consumers receive extensive disclosures, but home equity transactions are subject to the right of rescission. This means that a consumer having second thoughts about the transaction can cancel it at no cost within 3 business days. Thi[s] right of rescission was originally included in the Truth in Lending Act of 1968 precisely to protect consumers from unwitt[i]ng or improvident encumbrances on their homes, which is the newly expressed concern about home equity credit. In this regard, the law anticipated the problem by nearly twenty years.

Truth in Lending has been a dynamic law, and the Federal Reserve Board has not hesitated to adjust the rules where necessary to deal with new practices. The Board[,] mon[i]toring home equity credit practices carefully, has recently proposed specific amendments to Regulation Z to beef-up disclosures about termination rights and is studying the need for further regulatory strengthening.**

The TILA rules on disclosure and rescission are reinforced by state disclosure laws (that may expand the terms to be disclosed), and by federal and state laws prohibiting false advertising and deceptive and unfair practices.

In short, consumers have ample opportunity under existing law to learn the details of the transaction, and to consider cancelling it. While keeping an open-mind on [in]itiatives like the Price bill[,] we must point out that refinements in these rules, if needed, can probably be accomplished at the regulatory level without new legislation.

C. Other explicit federal law may enhance the protection of consumers entering into home equity transactions. For example, savings institutions offering variable rate credit under regulations of the Federal Home Loan Bank Board (12 CFR § 545.33 (1987)) will provide multi-page disclosures and the <u>Consumer Handbook on Adjustable Rate Mortgages</u>, at the time of the consumer[']s application. These disclosures constitute a full exposition of [the] creditor'[s] HELC plans, their terms, and their arithmetic. Those FHLBB regulations also control substantive provisions in the home equity transaction, such as rate caps, change intervals, permissible indexes, and the like. We question how productive it would be to layer another level of disclosures and contract limitations on these transactions.

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* 15 USC §16[illegible] et. seq.

** At an open meeting of the Board of Governors of the Federal Reserve System on September 9[,] the Board staff [i]nd[i]cated that they were presently working on a package of m[or]e [than] a dozen proposed amendments to the open-end credi[t] provisions of Regulation Z. Th[e] work was undertaken at the request of the Board's Consumer Advisory Council (CAC) and will be on the CAC[']s agenda at [i]ts mid-October meeting. Ba[l]loon payments[, a]cceleration or call provis[i]ons, and paymen[t s]chedule disclosures are some of the subjects covered by the pac[k]age of proposed amendments.

D. Consumers in home equity transactions may realize further substantive protections under state law. The exact content of state law will vary from jurisdiction to jurisdiction, but the states frequently legislate or regulate concerning such matters as --

- o Interest rate ceilings (usury laws);
- o Caps on the frequency and amounts of rate and payment adjustments in variable rate transactions;
- o The right to pay off prior balances, or to refinance a balloon payment, at the original rate;
- o Limitations on a creditor's right to declare default, accelerate balances, or foreclose on collateral (cf. Uniform Commercial Code § 1-208; Uniform Consumer Credit Code §§5.109, 5.110);
- o Maximum repayment schedules and restrictions on negative amortization; and
- o Mandatory lead times for changes in the terms of open-end credit plans (cf. Uniform Consume Credit Code § 3.205).

At the very least, any new federal initiatives should be crafted with due consideration of this substantial body of related state law protections.

In sum, we urge Congress to withhold action on all but the most focused of legislative initiatives est it duplicate existing law, and unnecessarily complicate transaction paperwork, increase creditor compliance costs, and stifle marketplace developments

III. New Disclosure Scheme Must Be Simple, Consistent With Existing Law And Not Redundant

If Congress deems it necessary to provide for additional consumer protection in this area, it should be limited to the types of application stage disclosures proposed in H R. 301 by Congressman Price. Our testimony has shown, we believe, tha more intrusive, substantive restrictions are neither necessary nor warranted at this juncture.

In particular, CBA must state its strong and unwavering opposition to any efforts aimed at imposing specific ceilings on HELC interest rates. Such ceilings or "caps" would prove harmful to consumers, by limiting HELC availability to select few of the least risky customers. Specific artificial pricing restraints would also have an anticompetitive effect on the HELC marketplace, forcing creditors out of the market and acting as a disincentive to remaining HELC providers to respond to market forces dictating rate reductions.

For these and other reasons Congres has never passed specific interest rate or other pricing restrictions for consumer credit,* electing instead to provide for the timely dissemination of credit shopping information to consumers. Congress has trusted the free market to regulate prices. We respectfully urge that Congress not deviate from this well-reasoned and time-tested approach.

Subject to certain modifications discussed below, the Price bill would compliment the traditional congressional approach to this issue. It seeks to provide consumers with key credit terms an early stage of the lending relationship without imposing undue burdens on creditor operations. As mentioned above existing law ready requires that consumers be given comprehensive disclosures and three-business day right to cancel the account relationship before they can access an HELC. So the question is what additional disclosures should be given to consumers.

* Section 1204 of the recently enacted Competitive Equality Banking Act of 1987, P.L. 100-86, contains an interest rate cap requirement for all variable rate loans secured by one-to-four family dwellings but does not provide for a specific limitation.

In answering this question, some guiding principles must be kept in mind. First, Congress must be wary of duplicating the detailed information required by existing law. A corollary to this principle is the need to keep additional disclosures simple. Finally, the detailed initial disclosure and right of rescission formulas in present law must not be disturbed.

The Price bill largely incorporates these principles by focusing on important HELC features at the application stage. CBA asks that you consider further refinements of H.R. 3011, not inconsistent with its objectives, including:

A. Limitation of the Application Disclosure Scheme to HELC's Secured by the Consumers "Principal" Dwelling. All other special protections accorded by the Truth in Lending Act to dwelling-secured credit transactions are limited to the consumer's principal residence or true household.* This also seems to be the focus of congressional concern here (rather than vacation or investment property . H.R. 3011 should reflect that focus by limiting its coverage to plans secured by a "principal" dwelling.

B. Inclusion of All "Generic" Information in the Federal Reserve Pamphlet. Section 3 of H.R. 3011 calls for the Federal Reserve Board to develop a consumer pamphlet describing general HELC lending practices and the potential advantages and disadvantages of HELC plans. Creditors are to distribute these pamphlets to consumers at the time f application.** We submit that some of the application stage disclosures ca led for under section 2(a) of the Price bil could be included in these pamphlets, thereby simplifying the application stage disclosure scheme. For example, interest only payment and change-in-terms features could be more briefly acknowledged in the segregated disclosure statement, where applicable, and discussed in the indicated detail in the pamphlet.

C. Limitation of "Conspicuously Segregated" Disclosure Requirement to Application Stage Disclosures. Section 2(a) of H.R. 3011 calls for the "conspicuous segregation" of the new HELC disclosures from other information provided in connection with the HELC plan. Since these new disclosures may also be required in connection with the initial Truth-in-Lending disclosure statement, there should be a clarifying limitation to the effect that this segrega- on requirement applies solely to the application stage. This would greatly reduce compliance burdens by eliminating the need for massive revisions to now standardized initial disclosure statements Such a limitation would in no way undercut the bill's early disclosure objectives.

D. Modification of APR Disclosure Requirement. Section 2(a) of H.R. 3011 calls for disclosure of the APR ". . . which will be in effect when credit is first extended " Since many of these plans lie "dormant" for long periods after they are opened, this reference point is unknowable and the disclosure requirement should be modified accordingly. Disclosure of a nominal interest rate applicable at or near the time the HELC was opened might suffice.

E. Provision of Disclosures Should be Triggered by Receipt of a "Written" (or otherwise "Completed") Application; Sending of Disclosures Within Three Business Days Following Phone or Mail Applications Should Suffice. The full panoply of Truth in Lending civil sanctions would apply to a failure to comply with H.R. 3011's application stage requirements. Failure to provide these disclosures to persons making purely casual inquiries or failure to insure that disclosures are actually received by telephone or mail customers within 3 business days should not carry such severe penalties.***

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* E.g., right of rescission, 15 USC §1635

** As presently framed, section 2(a) of H.R. 3011 could require such distribution at both the application and account-opening stages, a needless redundancy. The latter distribution requirement should be deleted.

*** Some consideration might be given to moving the Fed Pamphlet requirement into Truth in Lending's advertising rules (§143) if the goal is to provide earlier credit shopping information The advertising rules do not incorporate Truth in Lending civil sanctions. Creditors would be more inclined to disseminate information freely in the absence of the threat of civil liability.

F. The Advertising Requirements in Section 2(c) of H.R. 3011 Largely Duplicate Section 143 of the Truth in Lending Act and Should be Eliminated or Substantially Reduced. Proposed new TILA section 147(a) largely restates existing TILA section 143 and is, therefore, redundant. We note also that existing sections 105 and 143 give the Federal Reserve Board broad authority to require additional open-end disclosures. Since the Board staff is already in the process of promulgating such recommendations, we urge Congress to consider those initiatives before acting in this area. Finally the prohibition of references to "prime" in HELC account offerings seems excessive. Many HELC plans are literally indexed to prime rates and TILA disclosure would be difficult if not impossible without a reference to prime. Further, some HELC plans may carry proprietary labels using the word "prime". Board authority to restrict trade or service mark usage of this sort is unclear at best.

G. Uniform Federal Disclosure Rules Are Important. The disclosures required by H.R. 3011 should establish uniform credit shopping standards and should be comparable wherever the creditor or consumer is located. To ensure this objective, CBA recommends the inclusion of language clearly preempting the states from enacting different or additional disclosure requirements in connection with HELC applications. This approach has been adopted already this session by the House Banking Committee with respect to credit card application disclosures (H.R. 515). To our knowledge, no existing state laws have addressed application stage HELC disclosures; thus Congress would be acting only to keep the slate clean of potentially conflicting requirements and would not be intruding in an area of existing state law.

H. Additional Compliance Lead Time Is Necessary. H.R. 3011 provides only six months for regulatory implementation of extensive Truth-in-Lending amendments. Truth-in-Lending changes are currently effected on an annual basis providing for six months between the completion of final rulemaking and required compliance. We therefore suggest an extension of H.R. 3011's effective date to at least nine months after the date of enactment.

IV. Other Substantive Concerns

As the Subcommittee moves forward with these legislative proposals on home equity credit, CBA must clearly object to certain restrictive approaches that have been publicly discussed if not actually proposed in recent weeks.

A. We believe it inadvisable to legislate sweepingly in an area that is in such a state of flux and development as home equity lending. Today's speculation about problems does not always become tomorrow's reality. We have seen no evidence of creditor overreaching or consumer abuse. In fact, the impression is unavoidable that creditors are competing vigorously, imaginatively and responsibly, and that consumers are responding with enthusiasm and a good measure of prudence.

We ask Congress to exercise some caution before imposing new requirements on transactions that are saturated with disclosures and consumer protections under time-tested Truth in Lending rules. At the very least, Congress should give the Federal Reserve Board the maximum opportunity to address home equity lending at the regulatory level, a process already underway, before carving new legislative stone.

Congress should be especially hesitant to take action on the basis of an incomplete record that would have the perverse effect of limiting for consumers their access to the liquidity in their home equity. Burdensome regulation increases creditor costs, which must be recouped from customers. Stringent restrictions on contract terms are a disincentive for creditors to offer that product. Informed consumers vote with their feet -- they choose or reject financial services based on their perceptions of costs and benefits -- and they have shown a strong disposition to choose home equity credit. We question the wisdom of "preventative" action that would curtail that choice.

B. Much publicity has been given to the notion of "rate rise surprise." The concerns expressed are in fact objections to variable rate credit in any form, not just in home equity transactions. Adjustable rate credit is now well established and accepted, by credit extenders and borrowers

alike. Rate caps are not required by law to be incorporated into the contract, and both federal and state rules may restrict rate ceilings, rate adjustments, and payment-schedule changes The Federal Reserve Board has published proposals for revamping disclosures in adjustable rate purchase money mortgages. The policing of adjustable rate cred t s already occurring and needs no specia legislation for home equity transactions. Artificial (and arbitrary) rate caps, mandatory time limits and interval , prohib tions on rate floors -- these are ingredients of direct rate regulation, and ultimately of consumer credit allocation, subjects that Congress has properly avoided.

C. Much has also been said of the potential for consumer abuse in home equity transactions that permit the creditor to terminate or "acce erate" at will, confronting the consumer with a frozen redi ine, or a large balloon payment, or even foreclosure on the home We mply do not believe that this is problem of ny substance. For one thing, we do not know how widely such c uses are used in home equity credit, and have seen no data on t. More importantly ome forms of acceleration or termina on-at-wi clauses have been standard provisions in credit transactions for many years they are necessary precaution against the debtor's nonpayment or other defau t and there is a wel -established body of state law to discourage precipitous or bad faith exercise of such a clause.

Aside from legal restrictions, it is rarely in the creditor's own interest to misuse such a clause. If the consequence is that the consumer defaults on the ba loon ob igation, the creditor must either tiate foreclosure (an inherently unattractive prospect given the second mortgage status of the HELC creditor), or refinance the obligation itself. The refinancing is generally subject to the same controls as to rate and other terms, as the original transaction. Abusive exercise of a termination clause is, above all, poor public relations for ny financial institution.

The Federa Reserve Board has recently solicited comments on the operation and effect of termination auses, and has proposed to require disclosure of them. This was n the context of the broader Board study of home equity lending to which we have al uded Thi suggests first that Congress need not rush to fill a consumer protection void, and second that any remedial measures found needed may be capable of accomplishment by Board regulation without new legislation.

D. Suggestions that federal law should set maximum loan-to-value ratios for home equity credit would so deeply intrude the Congress into the substantive terms of consumer transactions as to deprive consumers of access to a portion of their home equity. A consumer needing or wanting to liquidate that equity could sell it, but could not borrow against it! In addition, the creditor is most likely to exercise self-discipline in setting a realistic loan-to-value ratio in order to protect it's investment.

The Consumer Bankers Association is proud of it's record of supporting well-drafted legislation to improve the flow of information to consumers and to prohibit truly abusive and anti-competitive practices. We share some of Congress' concerns abou the rapid growth of home equity credit, and have taken the lead in our industry to study that growth, and to educate our members and the public about possible problems.

We believe the evolving picture of home equity credit needs watching, and that those transactions may need further regulatory refinements. A process toward those ends is underway at the Federal Reserve Board, and we suggest the Subcommittee await the outcome of that activity. If the record of these hearings justifies it, we would support some sharply focused statutory disclosure rules for home equity transactions, similar to those proposed by H.R. 3011 and as modified by the recommendations outlined in this testimony.

APPENDIX A

What You Should Know About a Home Equity Line of Credit

CBA
CONSUMER BANKERS ASSOCIATION

6 Tips for Wise Use

By following these six guidelines, you can make … of your home equity line of credit:

1. Home equity credit … best used for *major expenditures* such … home improvements, children's college expenses, … major medical emergency expenses, … also be used … consolidate other debts at … lower interest rate. Because … the equity in your home represents … substantial … of savings, … should not be used … finance current consumption such as food, clothing and entertainment.

2. Don't borrow … than you … afford to *repay* … *a reasonable period* of time. For instance, if you … your line of credit to pay for … pay it off … you would pay off a regular car loan, usually over … period of three to five years.

3. *Interest only* payments … offered by some lenders, and may be appropriate when special circumstances may make it difficult or undesirable to pay down the principal, such … when children … in college. Generally, it's preferable to pay down principal to retire your debt.

With some plans, interest-only payments lead to … *balloon*, when the unpaid balance is due. This may be appropriate only for those who can predict that they can pay off their loan—perhaps because they plan to sell their home—or who are willing to refinance at the rate prevailing in the future. Be sure your income will be sufficient to qualify you for refinancing.

4. Total monthly payments … all types of loans should not exceed about *35 percent of your monthly before-tax income*. A good banker will help you determine how much debt you can afford.

5. Most home equity loans have … *variable interest rate*, meaning payments could fluctuate. Make sure you understand the terms and can afford the increase in the rate of interest if it should …

6. Interest payments on home equity loans *may be fully* … deductible. *Consult a qualified tax specialist*, as each homeowner's situation is different.

Questions to ask your loan officer:

- Is a home equity line of credit most suitable for my needs, … would another kind of loan be more appropriate?
- What is the initial … of interest? Is it fixed or variable? If … variable, … hat index is it based? How often can the rate change? Is there a cap or maximum increase in interest rate?
- What fees must I pay at the time of application and closing? Is there an annual fee?
- What will my minimum monthly payment be for each $10,000 in credit, and how much of the minimum payment will go to principal?
- If interest rates go up, will my minimum monthly payment go up with a variable rate loan? What … in rate would cause my payment to go up?
- Are there circumstances under which my outstanding debt can increase if … only make the minimum payment?
- Are there conditions under which I can reduce my monthly payment? Will I still be paying down principal?
- Under what conditions … the bank demand repayment … refinancing of my outstanding credit? Can any of the credit terms be changed without my approval?
- Do … have … option of converting my line of credit into a fixed term installment loan to pay it off? If so, at what interest rate, and over what period of time?
- If my income or … of available equity increases in the future, … have … line of credit increased? Will I have to pay new fees? Will I have to requalify?

CBA
CONSUMER BANKERS ASSOCIATION
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APPENDIX B

**CURRENT HOME EQUITY CREDIT LINE
DISCLOSURES REQUIRED BY
TRUTH-IN-LENDING ACT ("Act")/REGULATION Z ("Reg Z")***

Advertising (Act §143; Reg Z §226.16)

- Must be accurate
- Must reflect terms actually offered
- Use of "trigger" term requires additional disclosures

  e.g. trigger terms:

  - 17 % A.P.R.
  - Small monthly service charge on remaining balance.
  - $20 Annual membership fee buys you $2,000 in credit.
  - No finance charge if you pay your full balance each month.

  "Required" additional disclosures:

  - Any minimum, fixed, transaction, activity or similar charge that could be imposed
  - A.P.R. and variable rate, if applicable
  - Membership or participation fee

Initial Statement (Act §127; Reg Z §226.6)

(Written disclosures made to consumer before account can be opened)

- Finance charge: explanation of charges, methods of computation, free ride periods, periodic and annual rates and when they apply
- All other charges that may be imposed
- Security interest description
- Statement of federal billing and error resolution rights
- 2 right of rescission** notices because credit plan is secured by consumer's dwelling (see Act §125; Reg Z §226.15)

Periodic Statements (Act §127; Reg Z §226.7)

- Previous balance
- Identification of each transaction during the period
- Credits to the accounts
- Periodic and annual rates
- Balance to which finance charge is applied and how it is computed
- Amount and components of finance charge
- Actual A.P.R. for the period
- Other charges itemized and identified
- Closing date of billing cycle
- New balance on that date
- Free ride period
- Address for notice of billing errors

Subsequent Disclosure Requirements (Act §122; Reg Z §226.9)

- Statement of federal billing rights, at least annually
- New credit devices/features added to plan must be disclosed prior to usage by consumer
- A change in terms must be disclosed at least 15 days prior to effective date of change
- Right of rescission and notices, whenever credit limit is increased (see Act §125; Reg §226.15)
- Billing error resolution notices to consumers and others (see Act 170; Reg Z §§226.13(c), -(e) and -(g))

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* Act - 15 U.S.C §1601 et seq.
Reg Z - 12 CFR Part 226

** Consumer has 3 day right to cancel opening of account, i.e., 3 day "cooling off" period to review all terms of account agreement

TESTIMONY OF

MICHELLE MEIER
COUNSEL FOR GOVERNMENTAL AFFAIRS
CONSUMERS UNION

AND

ALAN FOX
LEGISLATIVE REPRESENTATIVE
CONSUMER FEDERATION OF AMERICA

PRESENTED BY

MICHELLE MEIER

ON

H.R. 3011: THE HOME EQUITY LOAN
CONSUMER PROTECTION ACT OF 1987

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

OCTOBER 6, 1987

Consumers Union* and Consumer Federation of America** appreciate the opportunity to testify on H.R. 3011, the Home Equity Loan Consumer Protection Act of 19 7. The heavy promotion of home equity loans is a recent phenomenom that raises major concerns for our organizations, and we congratulate you, Mr Chairman, for calling this hearing in a timely manner. We also wish to thank you, Congressman Price, for introducing the legislation before us today.

OUR PUBLIC POLICY CONCERNS

Few developments in the history of consumer lending have threatened the financial well-being of consumers more than the recent surge in home equity lending. This is because home equity loans are a unique combination of several traditional credit features, that, together, multiply the borrower risk inherently associated with personal debt.

Like traditional second mortgages, home equity lines of credit require the borrower to pledge his ownership rights in his residence as security. This not only subjects the borrower to the risk of losing his home, but it also means encumbering the major source of savings for individuals and households, which is no longer available for emergencies and old age.

Like traditional second mortgages, home equity loans also involve large sums of money This fact alone heightens borrower risk because t means e ther a protracted repayment period or large installment payments. A recent study by the Federal Reserve Board indicated that the median home equity credit line is about $25,000, and the median amount actually borrowed is almost $15,000.

Like credit cards, home equity loans also frequently involve "easy" repayment plans that stretch out the borrowers obligation indefinitely. Borrowers carrying high outstanding balances year after year are exposed to a high risk that at some point in time they will hit a snag in their abil ty to repay. With home equity loans, sudden illness unemployment or unexpected expense could have catastrophic consequences.

Like credit cards home equity loans are open-ended -- with the ease of writing a check, or even pulling out a credit card, the borrower can get instant cash. Although credit cards have benefited consumers with their convenience, problems arise when it becomes as convenient to put a second mortgage on your principal financial asset

The risks this new product poses for individual consumers are tremendous. The problems it raises for society as a whole are equally troubling. Although heavy consumer spending may help us avoid a recession in the short term, where will we be in

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*Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide information education and counsel about consumer goods and services and the management of family income. Consumers Union's income is derived solely from the sale of Consumer Reports, its other publications and films. Expenses of occasional public service efforts may be met, in part, by nonrestrictive, noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports, with approximately 3.5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

**Consumer Federation of America is a coalition of over 200 national, state and local consumer, senior citizen, labor, farm, cooperative and rural organizations which together represent more than 30 million people.

the next cyclical downturn when individuals have no savings to draw on? Where will we be twenty years from now when the baby boomers hit retirement age and have no savings to draw on?

The pros and cons of the tax law revision that has spurred industry's craze for this new product is not an issue before us today. However the risks inherent in home equity lending - risks to society and to individual consumers - should be kept in mind as we discuss the specific features of the HELs that are actually on the market today.

THE LOW-DOWN ON THE SPECIFICS OF THESE NEW PRODUCTS

As we have stated, open-end credit involving large dollar amounts and secured by the borrower's personal residence is inherently risky. The specific features of the home equity products now on the market make an inherently risky product even riskier.

•CAPLESS ARMS

According to recent surveys by our organizations of over 90 lenders, most HELs are an open-end version of the adjustable rate mortgage (ARM) that has now become familiar in the closed-end market. Unlike closed-end ARMs, however, the vast majority of home equity loans have no rate caps and allow unlimited rate increases This means that borrowers could face significant increases in their minimum repayment amounts, or "payment shock," which increases their risk of delinquency and foreclosure.

We do not argue that ARMs should be abolished. They cushion lenders against increased borrowing costs on relatively long-term loans. However, in the context of both closed-end and open-end credit, we believe that ARM features should reflect a fair allocation of rate risk between the lender and the borrower. We are now seeing such fairness in the closed-end ARM market Due to secondary market pressure, most closed-end ARMs now contain rate caps, many of which limit periodic rate increases and restrict lifetime rate increases to 5 points above the initial rate.

What is fair for consumers is also good business. Lenders must always balance rate risk (the risk that market rates will rise faster than the yields on their loan assets) with default risk (the risk that their borrowers will not be able to shoulder the debt and will default). With capless adjustable loans, lenders eliminate their rate risk but greatly increase their default risk. We doubt that the investors on the secondary market insisted on rate caps because of a sense of fairness to consumers. They saw that the caps that protect consumers also protect lenders and investors from default risk.

There is no secondary market for home equity loans. We cannot rely on such a market to force home equity lenders into offering a fair product.

•REPAYMENT TERMS

Balloon Payments - A number of lenders in the CU/CFA surveys offer home equity loans that hit the borrower with a balloon payment 5 or 10 years after the loan is made. At that point, the entire outstanding principal is due in one lump-sum repayment. Of course, none of these lenders guarantee that they will refinance the outstanding principal (which would involve substantial cost to the borrower, anyway) when the balloon comes due.

This type of loan feature poses obvious risks. The borrower who cannot come up with the entire repayment amount will have to sell his home to meet the obligation.

Demand Features - Some of the lenders in our surveys that do not explicitly require a balloon payment include contract features that could operate just as onerously These lenders reserve the right to review the loan periodically and if vague criteria are met, immediately demand its full repayment

•PROTRACTED REPAYMENT TERMS

Another feature common to the home equity loans involved our surveys was protracted repayment terms. As an inducement to borrow under these programs, the majority of lenders we surveyed are advertising "easy" repayment terms that frequently involve monthly payments of only the interest accrued on the outstanding balance.

•UNILATERAL CONTRACT MODIFICATIONS BY THE LENDER

The surveys also uncovered what appears to be a common practice among open-end creditors inclusion in the line of credit contract broad powers under which the lender can uni aterally change the contract terms This practice was inadvertently uncovered during the conduct of the Consumers Union survey, when a Bank of America spokesperson volunteered that in 1986 that lender had actually changed the formula under which the variable rate is calculated and applied the change to outstanding HEL borrowers.

Since completing those surveys, our organizations have seen HEL contracts used by several lenders They also include provisions that would allow the lenders to pull the same stunt.

We consider this to be an intolerable practice. Although it appears to be a longstanding feature of open-end credit, until now it has had little significance. Until now the biggest open-end credit market by far has been credit cards, which involve relatively small balance amounts and for which a post-contract change in rate only means going from bad to bad. Home equity loans involve vastly larger sums of money and a significant item of collateral. Neither should be subject to the tremendous risk involved when a lender can unilaterally change the rules of the game midstream.

•ADVERTISEMENTS

Now that the tax law has given lenders a great way to promote these products, they are being marketed at a fast and furious pace. With lots of creative glitz, the advertisements, which abound in all forms of media, promise easy repayment obligations and the "good life." They fail to mention many of the home equity loan features that we find so troubling:

- Lenders that require balloon payments rarely, if ever, disclose that fact.

- Although lenders promote their programs by advertising low initial rates they rarely disclose that the rates are uncapped and subject to unlimited increase.

- Although low initial rates are often discounted from the variable rate formula that otherwise applies some ads fail to disclose the current index rate, leaving the impression that the "teaser" rate will apply indefinitely.

- Lenders frequently promote their loans with the lure of tax deductibility, but rarely inform consumers that there are specific limits on the amount of interest that may be deducted.

- Similarly, lenders fail to fully disclose the upfront costs associated with opening a home equity credit line. These costs can run from $400 to over $1000, and significantly affect, or eliminate, the tax benefit of interest deductibility.

OUR LEGISLATIVE PROPOSALS

We believe the risks inherent in home equity lending warrant immediate legislation to protect consumers and society as a whole. Disclosure legislation is important, but it only goes so far. Home equity loans are complicated instruments the risks of which cannot be eliminated by disclosure. Substantive restrictions on product features must also be enacted.

H.R 011 is an important first step in ensuring that consumers will have much of the basic information they need to make a wise choice. However, we have several recommendations to make toward improving the disclosures required under the bill We also hope that the bill will be modified to incorporate the following substantive provisions that we believe are crucial.

OUR RECOMMENDED SUBSTANTIVE RESTRICTIONS

•Prohibit lenders from contractually reserving the right to change loan terms after the loan agreement is finalized.

•Require interest rate changes to be based on an index or other variable outside the control of the lender (E.g, the lender should not be able to change the loan rate according to the decisions it makes about adjusting its own prime rate)

•Limit rate increases to 2 points per year and 5 points over the life of the loan.

•Eliminate negative amortization, balloon payments, and interminable debt risk by requiring fully amortizing repayment installments that will retire the debt within a fixed, reasonable time period.

•Require that teaser rates remain in effect for at least 1 year.

•Require that rate increases under variable rate plans only apply to drawdowns made subsequent to the increase.

•Prohibit lenders from imposing contract terms that are different from those disclosed before the loan application is submitted unless the upfront disclosure clearly and conspicuously indicates that any particular term is not guaranteed.

•Prohibit use of the term "annual percentage rate" (APR) in describing the annual interest rate on home equity loans and substitute that term with another one that will allow standardi ed rate disclosure This will distinguish the rate disclosure for home equity loans (which does not and cannot include all the upfront costs) from the APR that is disclosed for closed-end credit (which does include the upfront cost).

OUR RECOMMENDED DISCLOSURE PROVISIONS

•Timing: The disclosures should come early enough so that consumers can use them to make a shopping decision. In keeping with this subcommittes approach to disclosure in the context of credit cards, the disclosures should come at the time the lender gives an application form to the applicant. The wisdom of this approach is also reflected in pending regulations proposed by the Federal Reserve Board in regard to closed-end ARMs.

•Content - The upfront disclosures should at least include the following

- The annual interest rate (For ARMS, this should include the entire rate formula including the index and margin, and the current rate under the formula. Additionally, if the loan involves a "teaser" or a low introductory rate that is not set according to the formula the lender should also disclose how long the teaser rate will remain in effect and what the current rate would be under the normal rate formula, with an explanation of what happens at the end of the introductory period).

For variable rate loans the lender should also disclose (a) whether there are periodic and lifetime caps and, if so what they are, and (b) the frequency with which payment and rate adjustments will be made and how they will be calculated

- All fees required to close the loan and to participate in the plan and a statement of when those fees are payable and whether they are refundable

- Repayment plans, including a clear description of each repayment options

- Whether the lender is willing to offer a lock-in

- The maximum payment allowed under the terms of the plan and the soonest that that payment could be required

An historical disclosure of what the loan payments would have been if a representative $10,000 loan were closed 15 years earlier (This and the preceding point are requirements included in the pending FRB regulations for closed-end ARMs.)

- This disclosure should be accompanied by an educational booklet to be provided by the lender. This booklet should describe home equity loans, how payment adjustments work, the rights the lender has against the collateral, and how the applicant can compare open-end costs with closed-end costs. It should also include a table for figuring the tax benefit, if any, of the tax law's interest deductibility provision.

Statement that the borrower's home is taken as security and that the applicant should consult the accompanying educational booklet for information about what this means.

Statement that there are limits on the tax deductibility of interest amounts and that the applicant should consult the accompanying brochure for more information.

We believe that legislation incorporating these substantive requirements and the disclosure requirements (with simi ar requirements regarding advertising) are urgently needed We look forward to working with the members of this subcommittee and the bill's sponsor toward the passage of effective remedial legislation.

STATEMENT
OF THE
UNITED STATES LEAGUE OF SAVINGS INSTITUTIONS
BEFORE THE
CONSUMER AFFAIRS AND COINAGE SUBCOMMITTEE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

October 6, 1987

Mr. Chairman, Members of the Subcommittee, my name is Kenneth J. Abt. I am President of First Federal Savings and Loan Association of Middletown, Middletown, New York, and am appearing today on behalf of the United States League of Savings Institutions. The League welcomes this opportunity to share its views on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987, as I do personally, for my own institution is an active provider of home equity credit.

At the outset, let me say that your focus at this time on home equity lines of credit is understandable and commendable. Because Internal Revenue Code changes basically have made home equity loans the only source of interest-deductible consumer credit, we have seen a considerable expansion of this type of lending. And I do not doubt that there have been some instances of over-promotion and under-disclosure. Given the fact that home equity lending by its nature involves placing liens on consumers' homes, typically an individual's most important asset, we wholeheartedly agree that it is appropriate for Congress to review the area for abuse and explore whether existing consumer protection mechanisms are adequate.

It is the League's view, and my own, that most of the concern about home equity lending stems from fear about what consumers <u>might</u> do to damage themselves financially rather than from actual knowledge about what homeowners <u>are</u> doing in the marketplace. Our experience is that homeowners are approaching home equity credit in a cautious and conservative manner, and this appears substantiated by survey data developed in 1987 for the Federal Reserve Board by the Survey Research Center of the University of Michigan, and for the Consumer Bankers Association by the Center for Financial Services Studies of the McIntyre School of Commerce of the University of Virginia. For instance, the Michigan study showed that 80% of all home equity borrowers had used only 50% or less of their available credit line, and the Virginia survey, in looking at variable rate borrowers, found the average person had accessed no more than 57% of his or her contractually available home equity credit. Indeed, many borrowers seemed to regard their home equity line as a special or even emergency credit source: this is reflected by the fact that home improvements were cited by both studies as the most frequently mentioned use of borrowed funds, and by the finding of the Michigan survey that, when asked, 31% of respondents reported no use of the credit line, more than 50% indicated no borrowing in the previous six months, and 20% showed only a single instance of borrowing.

Let me emphasize as well that the survey data reflected care on the part of lenders in granting home equity credit lines. The Virginia survey revealed that loan-to-value ratios approved for variable rate home equity loans, including the first mortgage balance, average less than 70% -- a very prudent approach to underwriting. Prudent underwriting also was revealed by that survey's profile of the typical borrower: a individual between 35 and 49 years old, earning $44,000 annually, who has been a homeowner for over 9 years.

That prudence and restraint on the part of both borrowers and lenders are the hallmark of the home equity credit arena is perhaps best illustrated by the very low incidence of delinquency and foreclosure revealed by the Virginia study. Delinquencies were 30% less than for all consumer debt, and the institutions surveyed averaged only 1.5 foreclosures annually.

These figures do not bespeak abuse. Rather they underline one of the central economic facts of home equity lending. Namely, that lenders like this line of business because the set of borrowers basically is self-selected for quality. People who have built up home equity against which they can borrow are, on the average, conservative people who can be relied upon not to shoulder undue financial burdens that ultimately may prove damaging to themselves and their creditors. It is this quality factor, buttressed by intelligent underwriting, that is the lender's primary economic safeguard in this context -- seeking to recover a debt through foreclosing on a mortgage lien - especially a junior lien -- is an expensive, time-consuming and acrimonious process.

Under these circumstances, we strongly feel that the most appropriate Congressional response is to ensure that disclosure mechanisms are in place that will assure that consumers of this financial product have the information they need to make an informed decision. The League would oppose steps that would be aimed at dictating other aspects of the home equity loan relationship, such as legislating specific rate caps, banning termination-at-will clauses, establishing maximum loan to value ceilings and forbidding negative amortization. The marketplace, drawing on clear and meaningful disclosures, will generate a far more useful and flexible product range for consumers than would emerge from a regime of statutorily dictated contractual terms.

We would object in particular to any legislation establishing specific interest rate limits for home equity loans, whether in terms of dictating the number of basis points rates could increase, employing an approach allowing rate adjustments to apply only on a go-forward basis, or mandating the duration of initial rates. The marketplace for financial services is a very competitive one, and, as long as consumers have adequate information available, they will find suppliers of products suited to their needs. In the home mortgage field, for example, fixed rate instruments remain a fixed presence, notwithstanding the dire predictions of those who resisted the authorization of adjustable rate loans.

Indeed, we believe that the widespread popularity of adjustable rate mortgages in the past four years made homeownership a reality for many American families who could not otherwise afford mortgage credit -- thus making a very significant contribution to housing's recovery from the 1981-82 spiral of interest rates. As you know, adjustable rate loans are marketed at a significant entrance discount over fixed-rate mortgage loans. According to estimates of the U.S. League's economics department, as many as 1.4 million more new and existing homes were sold in that period than would have been sold if only fixed rate mortgages had been available to homebuyers.

Let me stress that, in a marketplace where the interest rates on deposits have been deregulated, it would be a serious mistake to return to the practice of legislatively restricting, in effect, depository institutions' return on assets. We in the thrift industry paid a severe price for this sort of asymmetric approach to financial regulation in the past. Please bear in mind that financial controls of this kind, in addition to damaging suppliers of credit, also harm those who

must consume it, for such restrictive practices invariably limit the availability of credit and increase its cost. The only individuals who profit are those persons who reap the windfall benefit, ultimately subsidized by others, of enjoying financing terms inconsistent with changes in market conditions.

Regarding the termination-at-will clause, we wish to stress that such provisos are long-standing features of consumer credit arrangements and are a necessary safeguard for creditors. We regard their abuse as highly unlikely given state law protections and the general difficulty, expense and bad publicity associated with the foreclosure process.

As noted earlier, loan-to-value ratios in home equity credit extensions appear to be at very prudent levels; accordingly there seems to be no evidence adequate to justify legislating in this area. In any event, we believe quite firmly that lenders and consumers are far better equipped than any government body to decide what proportion of a borrower's home-equity prudently may be tapped to satisfy his or her credit needs.

Likewise, the negative amortization issue is one best left to the good judgment of the parties to the transaction. In some cases, a transaction that involves a degree of negative amortization, all things considered, may be the one best suited to the consumer's particular needs. We see no virtue in interfering with persons wishing to enter into such arrangements, particularly in the absence of a record of abuse.

Given our concerns about unnecessary and counterproductive governmental intrusion into the home equity lending process, we are gratified that H.R. 3011, introduced by Congressman David Price of North Carolina, focuses on disclosure, reflecting traditional Congressional preferences in this area. If the Subcommittee concludes that new legislation is needed to deal with home equity loans, we believe H.R. 3011 represents an appropriate vehicle, although, in our view, it needs to be modified in a number of ways.

Our preference, however, would be for Congress to defer any legislation at this time in light of the Federal Reserve Board's ongoing efforts in this area. Congress should not lose sight of the fact that the Truth-in-Lending Act, as administered by the Federal Reserve, has proved to be a powerful, dynamic and flexible tool for assuring informed consent. In particular, we note that Congress, in the form of section 125 of that Act, has mandated a right of rescission applicable to home equity loans secured by the borrower's principal dwelling. Consumers are given a three-day period during which they can back out of such a transaction without charge should they change their minds. This right, together with current disclosure authority, strikes us as representing an adequately protective regulatory regime.

Turning to the modifications that we believe should be made to H.R. 3011, we note as an initial matter that the bill would duplicate a number of existing Truth-in-Lending requirements in Subpart B of Regulation Z. We strongly urge that the Subcommittee work with the Federal Reserve to assure that any new legislation does not overlap with existing law and generate redundant and expensive new paperwork requirements. Not surprisingly, these disclosure burdens fall most heavily on the smaller neighborhood and community institutions.

As a second matter, we urge that any special disclosure requirements imposed by the bill should apply only to the borrower's principal residence. The particular concern in Congress over home equity loans strikes us as centering on the

possibility that an individual in default may lose his home. We suggest that the possibility of losing investment or vacation property is not an issue meriting special attention within the Truth-in-Lending context.

A third point of concern involves disclosure timing. We suggest that requirements for disclosure for home equity loans be made consistent with those governing closed-end credit, thus allowing consumers to obtain all relevant information at one time. This could be accomplished by altering the bill to require the home equity line disclosures to be made before the first transaction or within three days of the application, whichever is earlier.

In this regard, but as an aside, the U.S. League has long felt that the best point for Truth-in-Lending disclosures in the chain of events in a home purchase may well be when the prospective purchaser receives the professional services of the real estate agent. That is often the point when credit is arranged. It continues to strike us as remarkable that, by law (as provided by section 702 of the Garn-St Germain Act), real estate agents are exempted from consideration as "arrangers of credit". While I appreciate that home equity loans occur after the time of initial purchase, I wished to take this opportunity to remind the Subcommittee that it is our view that the more general question of the appropriate time for disclosure deserves its attention in the general context of Truth-in-Lending.

Our fourth suggestion is that the bill be adjusted to limit to the application stage the "conspicuous segregation" requirement relating to the new home equity disclosures. This would reduce the need for extensive and expensive changes in standard disclosure statements, without sacrificing disclosure effectiveness.

Fifth, we wish to point out that, because home equity lines frequently are not utilized for substantial periods after their establishment, the bill is impractical in seeking to require disclosure of the APR that would be in effect when credit was first extended.

Finally, we believe that existing advertising requirements are adequate to curb abuses in this area, but have no particular objection to the limits proposed in H.R. 3011, with one exception. The phrase "loan at prime" does not strike us as so inherently deceptive as to merit being banned (many home equity loans are indexed to the prime rate), and we urge you to reconsider this proposed limitation.

In conclusion, Mr. Chairman, we must commend you and your colleagues for the promptness with which you are reviewing developments in the home equity loan area. We believe this product is proving to be a very useful one for both lenders and borrowers, enabling the latter in particular to have more convenient access to their most significant asset -- the equity in their homes. While we are confident that on the strength of the record of this hearing you will be content for the time being to let the Federal Reserve deal with the situation under existing law, should the case be otherwise, we would be willing to support a strengthening of disclosure requirements on the H.R. 3011 pattern.

I appreciate having had this opportunity to share our views with the Subcommittee, and will be happy to respond to any questions you may have.

Statement

of the

National Council of Savings Institutions

on Home Equity Loan Disclosures

Presented by

John H. Wood

Chief Executive Officer

MassBank for Savings

Reading, Massachussets

before the

Subcommittee on Consumer Affairs and Coinage

Committee on Banking, Finance & Urban Affairs

United States House of Representatives

October 6, 1987

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Statement

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United States House of Representatives

October 6, 1987

Mr. Chairman, my name is John H. Wood. I am chief executive officer of MassBank for Savings in Reading, Massachusetts. MassBank for Savings is an FDIC insured stock savings bank with approximately $318 million in assets.

I am pleased to have the opportunity to present the views of the National Council for today's hearings concerning disclosure requirements for home equity loans. I currently am serving as the Chairman of the Council's Consumer Loans Committee.

The National Council of Savings Institutions was formed in 1983 by the consolidation of the National Association of Mutual Savings Banks and the National Savings and Loan League. We represent approximately six hundred savings banks and savings and loans with total member assets approaching $500 billion, or 40 percent of the thrift industry's total assets.

Mr. Chairman, let me state that the National Council supports the approach of Congressman David Price when addressing the consumer's need for proper disclosure of terms for home equity lines of credit (HELC). We do, however, oppose restrictions or limitations imposed on home equity lending programs which in turn could adversely affect lenders and the availability of the product for consumers.

Background

Home equity lending is an important refinement in the second mortgage products that our members have been offering consumers for some time. These loan products represent a healthy diversification of savings institution's portfolios since second mortgages are shorter term than first mortgage loans, and often carry variable rates of return. Second mortgages and home equity credit lines are financial products that today's consumer expects to find at leading providers of financial services.

As many institutions have attempted to diversify into consumer loan products such as car loans or credit cards, they have discovered a very competitive, crowded market. In the case of automobile loans, for example the competition from captive finance subsidiaries offering "advertised" rates as low as 1% is stiff competition indeed. Savings institutions are ideally suited to offer home equity credit loans since well established consumer relationships (through first mortgage lending) and mortgage lending departments are the foundation for good home equity lending programs.

Home equity loans act as revolving lines of credit in which a qualified homeowner may draw on an established account. The maximum loan amount is based on two factors: the percentage of equity built-up in the home and the

ability of the borrower to make payments. Typically home equity loans are used for home improvements, education, medical emergencies, and the purchase of major consumer items such as boats or cars, among others. HELC's differ significantly from previous revolving lines of credit in the fact that loans are secured by the homeowners dwelling.

Home equity loans offer the borrower features not available with unsecured or traditional loans. The first important benefit is cheaper rates. Since the loans are secured by real estate, the borrower can get funds at more attractive rates than if it is a signature or unsecured loan. The second primary feature is convenience. Since the line of credit can be established at one time, and drawn down as the borrower needs the funds, it is easier for an individual to manage his or her debt than otherwise would be the case. This is a major benefit over the traditional second mortgage.

1986 Tax Reform Act

Another important feature of these loans was recently added through actions of the Congress when it restricted the deductability of interest on certain loans. Home equity loans have received much attention in media markets within the short time following the passage of the Tax Reform Act of 1986. This tax law will phase out interest deductability for unsecured consumer credit by 1991. One exception still remains however, and that is the ability to deduct interest incurred on debt secured by a taxpayer's primary and secondary residence, within the limitations of the 1986 Tax Reform Act.

When speaking about the ramifications of the Tax Act on the second mortgage markets, it is important to remember that only 37% of taxpayers currently itemize their deductions, and this number should go down after the new tax law takes effect. However, the restrictions on tax deductions for traditional consumer loans have created a greater interest for an alternative product which will help consumers replace some of the lost tax advantages with credit card, automobile, and other personal loans.

Recently, legislators and regulators have been concerned with borrowers' increased exposure to the potential risk of losing his or her home due to an inability to repay the home equity loan. The National Council shares this concern. Clearly some of the hard sell advertising for home equity lending has been unfortunate, but it appears that such advertising is an exception, and not the rule. We are attaching for your review as exhibit A an ad that one of our members, the Germantown Savings Bank, has used. This is representative of much of our membership's approach to this important financial product.

Need for Consumer Awareness

Because the purchase of a home is the most important investment made by most, any loan agreement which could affect such homeownership should be thoroughly understood and assessed by the consumer. Another of the Council's members, the Maine Savings Bank hands out a booklet with important practical advice to potential home equity borrowers. The entire text of the booklet is attached as exhibit B.

It is important in today's increasingly complex mortgage marketplace that proper and understandable disclosure information be provided to any potential borrower. The National Council has supported past efforts to further educate consumers on the mechanics of various mortgage products. In 1984, the National Council worked in conjunction with other industry trade groups, the Federal Reserve, and the Federal Home Loan Bank Board to develop The Consumer Handbook on Adjustable Rate Mortgages. This consumer information brochure has proven to be the most useful tool in describing the ARM. We would continue to support similar educational efforts such as these for home equity loans.

The Council will soon be sponsoring a program for the industry on Home Equity Credit Lending, and we have placed a high priority on emphasizing the consumer's concerns in this line of business. We will be hearing from Congressman Charles Schumer and a representative of Consumers Union to underscore the importance of the consumer's best interests.

Market Experience

As the Congress approaches the question of necessary consumer safeguards in the home equity lending area, it is important to keep certain things in perspective. First, the highly visible marketing of these programs is very competitive as providers of financial services attempt to maximize lending programs that many feel will be spurred on by the new tax law. However, a recent survey taken by the Survey Research Center (SRC) of the University of Michigan on behalf of the Consumer Advisory Council of the Federal Reserve shows that, "As if April 1987, 6% of homeowners had established lines of credit secured by their homes. In addition, 1% of homeowners had applied for such accounts but had not yet received approval."

The SRC survey also shows that, "Consumer awareness of the availability of HELC is high (80% of all homeowners stated they knew about such accounts). However, nine-tenths of homeowners who were aware of such accounts but had not yet applied for one stated that they were not interested in opening such an account in the near future."

Second, a major portion of the home equity lending business will represent a substitution of consumer debt transferred from credit card, automobile, boat, and other unsecured personal loans. This transfer of debt will represent a savings to the consumer in the form of cheaper borrowing costs. This is also borne out by the SRC study.

As the Congress addresses the issue at hand, the Council would urge that no restrictions be placed on the ability of lender to structure loan product as this will stifle market development. Since the introduction of home equity loans, there has been experimentation and product development by the industry in addressing problems that may still exist. As with any new mortgage-related product, there is bound to be the need for a revising and tightening of underwriting methods, marketing strategies, product design and proper disclosure for consumers.

ARM Comparison

If we simply look back a few years to when adjustable rate mortgages (ARM) were the latest mortgage instrument, we can see many of the concerns addressed then resurfacing today with regard to home equity loans.

The early stages of ARM introduction met with borrower resistance. Borrowers were not willing to accept the ARM without protection against unrestricted interest rate increases. In addition there was little product standardization. To remain competitive, creditors were forced by the market to adjust their product to include lower initial interest rates and caps.

Today, most ARMs have both annual and life of loan interest rate caps to protect borrowers. It cannot be overemphasized, that a mutually beneficial ARM product for both lenders and borrowers was developed without restrictions imposed by Congress or regulators. We are certain that an unrestricted environment under which the ARM product developed will provide similar positive results for home equity loans.

Today, consumers are becoming more sophisticated in their knowledge of new variable rate mortgage products. They are exerting extreme caution when undertaking large debt, especially debt which is secured by their homes. As was shown with the ARM example, borrowers will not accept a

product which poses substantial risk. From the lender's viewpoint, we work to provide a stable and efficient instrument that reduces overall costs and minimizes losses due to foreclosure. It is not to the lenders advantage to offer a product which will be impossible for the borrower to repay. Foreclosure on a property can cause serious losses for both consumers and lenders.

H.R. 3011

We feel a market-determined home equity loan is the best solution to any problems arising today. We therefore urge Congress not to restrict lending practices, but allow the market to dictate a workable home equity product. We wish to commend Congressman Price for ntroducing a bill which keeps a realistic perspective on the ome equity lending market and addresses potential problems through better informing the consumer and not through the imposition of arbitrary restrictions on the market.

Although we applaud Congressman Price for not placing interest rate cap language in his bill, federal legislation has already been passed in this area, an unfortunate initiative in our view. Section 1204 of the Competitive Equality Banking Act of 1987, which was signed into law on August 10, requires that all open- and closed-end adjustable rate consumer credit which is secured by a borrower s primary and secondary dwelling nc ude maximum lifetime caps by December 8. Although we are distressed over the broad implications of such artificial term constraints, we are relieved that Senator Metzenbaum and the Federa Reserve have left the setting of such cap amounts to the lender's discretion.

The action taken by Rep. Price in introducing H.R. 3011 and the hearings being held by this Subcommittee are timely actions that will clearly help the regulatory process receive important Congressional input. In November, the Consumer and Community Affairs staff of the Federal Reserve is expected to submit to the Board for approval a proposed rule on open-end credit disclosure requirements. While we do not know the content of this proposal, we look forward to working once again with the Fed staff in this area.

I would now like to address some specific elements of H.R. 3011.

Section 127 of the Truth in Lending Act as amended by H.R. 3011 would raise some possible unclear situations. Section 127 c)(3 (A) would require disc osure of the APR at the time credit s extended, but disc osure would be given at the time of application, which may occur month or years before credit is actually extended. This section should be amended to make clear that the lender would disclose the APR at the time of application, and would explain the methodology for changing the rates in the future as is required in Section 127 (c)(3)(B).

Section 127 (c)(3)(D) should be amended to reflect the fact that many lender's adjustment periods are not one year periods. Some are more frequent, others less frequent. The lender should be required to show the maximum amount by which the APR may change in any adjustment period. Since all home equity lines used for consumer purposes must carry a life of loan cap, the last sentence of subsection (D) and (E) should be deleted.

Section 127(c)(3)(F) may create a situation that is unfair to loan programs that do not use an annual or periodic interest rate cap. The last part of that subsection establishes an example for such loans showing a three percent annua change and 8% life of loan change. Since the last two years have experienced rate changes less than three percent, it would seem that it is unfair to show these loans in a less favorable light than those loans with an annual percent rate cap that would be able to give an example based on actual interest rate experience. This section should also be clarified to show that loans with periodic rate caps (and not just annual rate caps) could give an historic example, and not the one spelled out in

th. legislation.

However, some members of the Council have expressed concern that using an example of rates going over the past two years as suggested in Section 127(c)(3)(F) may give consumers a distorted view. This is because the example suggested is based on interest rate affects on payments over the past two years when interest rates have been low.

Loan definition. Finally, we would suggest that H.R. 3011 be amended to make clear that this legislation will affect only consumer credit, and that it not apply to commercial loans. This point would be consistent with the legislative and regulatory history surrounding the aforementioned Metzenbaum amendment to the recently passed banking legislation.

Mr. Chairman, I would like to thank you for the opportunity to appear before your subcommittee today, and I would be happy to answer any questions you might have.

EXHIBIT A

EXHIBIT B

THE ONE EQUITY LINE OF CREDIT

IT CAN HELP YOU HANDLE YOUR MONEY BETTER

We think you'll find The One Equity Line of Credit the most versatile, easy to use loan you've ever had. And in order to help you use this loan to your best advantage, we've enclosed some valuable information designed especially for The One Equity Line clients. No matter how you plan to use your loan, now or in the future, these cards will give you some helpful suggestions on how to best use your home equity. We hope you find them useful. If you have any questions now or later, please just give me a call!

BUILDING A SECOND HOME

The One Equity Line of Credit can help you finance the construction of a second home or other recreational property.

Before you start, here are some suggestions you may want to consider:

-If you are considering the purchase of a parcel of land to build on, be sure to check with the local building inspector to determine what information or documentation is necessary to be sure that the parcel is buildable.

-Before purchasing the real estate, you should also contact an attorney to conduct a title search on the property to be sure that you will have a clear and marketable title.

-Check you city or town's building code to be sure that your project will be in compliance with any applicable ordinances and zoning requirements. Be sure to determine whether you or your contractor will be responsible for obtaining any permits, licenses or other municipal approvals and then make certain they are obtained.

-Contact more than one contractor to get written bids. You may be surprised at the vast disparity in price and time to complete between contractors for the same job.

-Get references on each contractor from people they have worked for and make a visual inspection of recent examples of their work. You may prefer one contractor's style and quality over another s.

-Contact an independent appraiser or REALTOR to determine whether the value of the property, once you complete construction, will not represent an over-improvement for the area.

-Make certain you understand the terms of the contract you sign with the contractor, especially concerning progress payments, payment of subcontractors, and the timeline for the project. If you have any questions at all, see you lawyer before you sign.

-Protect yourself against liens for non-payment of subcontractors by receiving lien waiver agreements from the contractor and any subcontractors. This will protect you in the event that the contractor fails to pay the subcontractor.

-Do not make the final payment until you are satisfied that the work compl es with the terms of the contract. If necessary, negotiate a "Hold Back" amount with the contractor to cover work which must be corrected or modified, ncluding a scheduled completion date by which the contractor must complete the work or forfeit an agreed amount. By retai ng a certain amount of funds, you wil be in a better position to have the work completed satisfactorily by a different contractor.

PURCHASING INVESTMENT REAL ESTATE

The One Equity Line of Credit can help you finance the acquisition of investment property.

Here are a few items you should consider before undertaking this investment:

-In order to protect your interests, an attorney should represent you. Your attorney can also conduct a title search of the property to ensure that the title is clear and marketable.

-Before purchasing the property, ask the seller for operating expense statements on the property. This can assist you in determining the earning potential of the property.

-Engage an independent appraiser to appraise your proposed purchase in order to determine if you are paying fair market value. (Maine Savings Bank can suggest independent appraisers if the property is located in Maine.)

-Determine whether any property improvements are necessary immediately or in the near future and include their projected costs in your expense calculations. Be sure to include any additional borrowing costs as well.

-Have an accountant go over the ncome statements on the property to ensure that you are aware of all tax implications and that the property will be a profitable investment.

-If the property cannot support a professional manager, consider the cost and time necessary for you to travel to and manage the property yourself.

COLLEGE EXPENSES

Use The One Equity Line of Credit to help you finance college, graduate school or other higher education.

Consider these facts before tapping the equity in your home for such expenditures:

-Even though your income may not permit the full borrowing for a subsidized Guaranteed Student Loan (up to $2,625 annually the first and second year and $4,000 annua ly the third and fourth year) don't automatically assume you are ineligible. Be sure to nvestigate that possibility thoroughly first by contacting your Maine Savings banker to explore your borrowing options.

-Don't assume that student loan requirements and eligibility guidelines will be the same every year Fi out the financial aid forms each year to determine el gibi ty for a Guaranteed Student Loan or any other scholarship or grant programs the col ege may offer.

-Depending on the nstitution you may be offered an alternative borrowing source directly from the schoo., or the school may provide some ncentive if you elect to prepay any or al of the expenses for a particular program.

-Or you may wish to consider the Parental Loan Program of up to $4,000 per year, or, for independent students, the ALAS Program of up to $4.000 per year for graduate students and $2,625 per year for independent undergraduate students. These loans' fixed rates and longer terms may help to make the cost of education affordable while holding part or all of your home equity in reserve. Again, check with your Maine Savings banker about these options.

INVESTING OR BUYING A BUSINESS

The One Equity Line of Credit can be used to help finance the expansion or acquisition of a business, to invest in stocks and bonds, etc.

Here are some suggestions if you use your home equity for such investments:

BUYING A BUSINESS

-If you're thinking of buying a business, several years' income statements and balance sheets of the business should be analyzed to determine the viability of the business, the market for the products and stability of its customer base.

-Review the company's business plan carefully to determine if it is reasonable and its goals achievable.

-An accountant should be called in to review the balance sheets of the business.

-Your own attorney should always be consulted to protect your interests in any transaction.

-If you are using your equity as only a portion of the cash investment required, factor into your business plan the cost of additional borrowing.

STARTING A BUSINESS

-The same considerations for purchasing a business apply to the evaluation process n the decision to start a new business (see above), but because of the relatively high failure rate in new businesses, extra caution must be exercised and there must be dditional funds available either through an unused equity line or outside sources.

-We do not recommend using advances against an equity line to start a new business unless income levels as shown in the original application are continued in order to service the loan in the event the business is not successful.

OTHER INVESTMENTS

-Investment strategies can target short-term growth or longer-term retirement goals. Consider IRAs, Keoghs, or SEPP plans. Talk to your Maine Savings banker to find out which option is best.

-Neither stocks nor bonds nor mutual funds involve guarantees of return or appreciation. Consider the consequences of losses as well as gains before you invest.

-To invest in stocks, bonds, mutual funds or other similar investment vehicles, you may wish to contact Winslow Investment Company, a subsidiary of Maine Savings Bank, for both advice and discount brokerage services.

-Talk to the people at Winslow Asset Management if you're interested in having a personal financial plan designed and managed for you.

HOME IMPROVEMENTS

You can use The One Equity Line of Credit to finance a home remodeling job or other home improvements.

Here are some suggestions to get you started:

-Contact more than one contractor to get written bids on your home improvements. You may be surprised at the vast disparity in price and time to complete between contractors for the same job.

-Get references on each contractor from people they have worked for and make a visual inspection of recent examples of their work. You may prefer one contractor's style and quality over another's.

-Check your city or town's building code to be sure that your project will be in compl ance with any applicable ordinances and zoning requirements. Be sure to determine whether you or your contractor will be responsible for obtaining any permits, licenses or other municipal approvals and then make certain they are obtained.

-Contact an appraiser, REALTOR or other Real Estate professional to determine if the improvements will actually add value to your property. You may want to think twice if such a real estate expert feels your improvement will "over-improve" your property for the neighborhood, making it difficult to recover your investment should you decide to sell.

-Make certain you understand the terms of the contract you sign with the contractor, especially concerning progress payments, payment of subcontractors, and the timeline for the project. If you have any questions at all, see your lawyer before you sign.

-Protect yourself against liens for non-payment of subcontractors by receiving lien waiver agreements from the contractor and any subcontractors. This will

protect you in the event that the contractor fails to pay the subcontractor.

-Do not make the final payment until you are satisfied that the work complies with the terms of the contract. If necessary, negotiate a "Hold Back" amount with the contractor to cover work which must be corrected or modified, ncluding a scheduled completion date by which the contractor must complete the work or forfeit an agreed amount. By reta ning a certain amount of funds, you will be in a better position to have the work completed satisfactorily by a different contractor should there be a problem.

CARS, ANTIQUES, ART, YACHTS...

Use The One Equity Line of Credit to write yourself a loan to finance larger purchases.

Here are a few things you should consider when purchasing other assets such as antiques, art, collectibles, a car, boat, etc.:

-Shop carefully. Be sure you are paying fair market value for your purchase.

-If purchasing a depreciating asset such as a car, boat or recreational vehicle, consider paying down the principa part of the loan balance (as well as the interest) on a regular basi so t is totally paid back in a reasonable period of time. Otherwise you may eventually be left with an outstanding debt which is much greater that the depreciated value of the asset.

-Your Maine Savings banker can set up a monthly amortizing payment schedule in order that your loan balance is "paid down" as your purchase depreciates.

-If purchasing an appreciating asset such as high quality jewelry, art or antiques, you should have these investments appraised to determine their market value. This will help to ensure that you are not over-paying for your investments, making it difficult to recover your expenditure should you decide to sell them at a later date.

-Be sure to maintain adequate insurance on all of your assets. Contact an insurance agent experienced with your particular assets to help you determine whether your assets are adequately documented and protected.

Statement of

David H. Pohl

Senior Vice President

Gibraltar MoneyCenter, Inc.

San Diego, California

For the

American Financial Services Association

Before the

Subcommittee on Consumer Affairs and Coinage
Of the
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives

On

Home Equity Loan Consumer Protection Act of 1987
(H.R. 3011)

October 6, 1987

Mr. Chairman, Members of the Committee, I am David H. Pohl, Senior Vice President of Gibraltar MoneyCenter, Inc. of San Diego, California, and Chairman of the Real Estate Lending Section of the American Financial Services Association (AFSA)*.

I appreciate the opportunity to appear before you today to present AFSA's views on H.R. 3011, the Home Equity Loan Consumer Protection Act of 1987. I would like first, to define some of the terms which are commonly used to describe home equity lending; second, to discuss some of the criticisms of home equity lending products; third to discuss how these products are regulated and then, in that context, to address AFSA's concerns about H.R. 3011.

Home Equity Loans - Definitions

The term "home equity loan" refers to any loan secured by residential property other than the primary loan to purchase the property. Although many believe that home equity lending is a relatively new phenomenon, its roots can be traced to the late 1800's when building and loan societies used this method to help people buy homes. Home equity lending has long been a major type of lending for many AFSA member companies. However, the predominant form of home equity lending was and still is the closed-end, fixed-rate loan, also widely known as the "second mortgage". Only within the last few years have more and more lenders begun to offer open-end home equity lines of credit.

In numerous recent articles and discussions on the subject, broad-brush characterizations have been made about all home equity loans. Quite often, no effort is made to distinguish the closed-end, fixed-rate loan (the traditional second mortgage) from the relatively new open-end home equity lines of credit. These types of loans have inherently distinct characteristics. but are similar in the respect that they are loans secured by the owner s interest in residential real estate. Both fall into the generic category of "home equity loan".

To maintain consistency throughout this testimony, I will use the following terminology:

TERM	DESCRIPTION
Second Mortgage:	Closed-end fixed-rate or variable rate loan secured by consumer's dwelling.
Home Equity Line of Credit:	Open-end, variable rate or fixed-rate loan secured by consumer s dwelling which can be accessed by cash advance, check or credit card.
Home Equity Loans:	Generic term describing second mortgages and home equity lines of credit.

*AFSA is the nation's largest trade association representing nonbank providers of consumer financial services. Organized in 1916, AFSA represents a diversified group of companies ranging from independently-owned consumer finance offices to the nation's largest financial services, retail and automobile companies.

Over the last decade, home equity loans have become increasingly popular. For example, among a representative sampling of AFSA members, home equity loans outstanding grew from $2.4 billion in 1977 to $15.9 billion in 1986

More recently, home equity lines of credit have caught consumers' imagination as more financial institut ons offer these products. The 1980 technical amendments to the Truth-in-Lending Act, which made revolving credit products feasible, made their growth possible Home equity lending has skyrocketed from $5 billion in outstanding loans in 1971 to over $150 billion in 1985 (according to data published by the Federal Home Loan Mortgage Corporation). According to Moebs Services, a Lincolnwood, Illinois research firm, outstandings exceed $225 billion.

Consumers like home equity lines of credit because they provide a relatively inexpensive and readily accessible source of funds. Consumers can borrow as much or as l ttle as needed depending on the size of their credit line and the minimum advance requirements set by the lender. According to a recent Federa Reserve Board survey, conducted by the University of Michigan's Survey Research Center (the Fed-Michigan survey), consumers most often use home equity lines of credit to consolidate debt make home improvements purchase automobiles and to defray educational and medical expenses

These products provide a source of credit which "travels" with the homeowner, thereby ensuring a reliable easy, and low-cost method to gain access to funds when needed.

Financial institutions like home equity lines of credit because they historically have a low delinquency rate and, because of their large size in comparison to other consumer loans have a lower cost to loan-dollar ratio. Home equity lines of cred t attract a more upscale and sophisticated customer who may continue to utilize other services offered by the financial institution.

While AFSA's traditional membership - consumer finance companies - have been involved in home equity lending for a long time, it still is a fledgling product line in other sectors of the financial services industry. From AFSA's viewpoint, our competitors are only now learning what we have known for years that home equity lending is both attractive and beneficial to consumers as well as safe and profitable for financial inst tutions

In fact, the soundness of home equity lending is clear. For example, in contrast to personal loans at finance companies, second mortgages show much lower delinquency and default characteristics AFSA research department data showed that 1. 9% of finance companies home equity loans (primarily traditiona closed-end second mortgage loans) were more than 60 days delinquent By comparison 60 day delinquency in unsecured lending was 4 5%.

To further illustrate the lower delinquency of home equity lending, the U.S. League of Savings Institut ons 198 Consumer Lending Survey showed 0 8 of noncredit card-accessed open-end equity loans and 2 3% of cred t card-accessed open-end equity loans were more than 30 days delinquent. De inquencies for first mortgage loans are running much higher The Mortgage Bankers Association s national delinquency survey reported that 5 3% of all one-to four-unit residential mortgage loans were more than 30 days delinquent as of December 1986.

The variable rate feature that characterizes most home equity lines of cred t is an added attraction to lenders seeking to protect their portfolios from periods of volatile interest rates.

AFSA Supports Consumer Education

Naturally, AFSA is very concerned about advertising and lending practices which may reflect adversely on the integrity of this business. For that reason AFSA supports full, clear and accurate disclosure of home equity loan terms, in a manner that is meaningful to both the borrower and potential borrower.

Beyond supporting the objectives of the Truth-in-Lending Act (TILA), AFSA has taken steps to contribute to consumer awareness of the nature of these products.

AFSA is conducting a consumer education program which alerts consumers considering applying for a home equity loan:

- That such loans entail a security interest in one's home.
- That variable rate and payment plans should be analyzed to see how they fit in one's household budget
- That consumers should seek competent tax advice.
- That consumers should shop for the terms and conditions which best meet their needs.

This program has received wide-spread attention in the press. (<u>See</u> appendix)

AFSA upholds a Code of Ethics, a condition of membership in the Association, that emphasizes complete and accurate advertising and disclosure of loan terms. Two provisions of the Code are particularly appropriate

- Members will explain fully to customers the cost, terms, and contractual obligations of credit transactions. Written instruments will be as simple lucid, and unambiguous as circumstances will permit.
- Truth in advertising will be the guiding principle of all promotional efforts thus enabling potential credit users to make an intelligent marketplace decision.

Additionally, the Federal Trade Commission, which remains the primary federal regulator of most AFSA members, has given AFSA permission to reprint and distribute copies of their manual "How To Advertise Consumer Credit". In sum, AFSA is mindful of consumer information, advertising and disclosure practices in promoting home equity loans and continues to advocate adherence to such standards.

Home Equity Lending Under Fire

Recently, two consumer groups have called on Congress to enact increased disclosure requirements for home equity loans. Their proposed measures would also prohibit balloon payments and negative amortization plans. AFSA believes that these proposals are based on the following implied assumptions: (1) there is a widespread problem with disclosure and advertising by financial institutions offering home equity loans; (2) consumers are too unsophisticated to understand the consequences of their actions; (3) lenders do not disclose terms and conditions in order to gain ownership of the security and (4) home equity lending is now substantially unregulated.

These assumptions are false.

Lenders Disclose Terms And Conditions And Comply With Advertising Standards

Lenders comply with a host of state and federal disclosure statutes and regulations. If anything, we are now approaching the point where consumers are being confronted with

"over-disclosure". In each home equity transaction, a borrower is given a voluminous amount of paper work As described later, disclosure requirements are already prevalent for home equity lines of credit on the federal and state levels.

Advertising of home equity lines of credit has especially irritated consumer groups One group stated in a May 11, 1987 press release that "banks are heavily promoting these credit lines by promising the good l fe with easy repayment terms. But instead, they'll keep consumers in a perpetual state of debt and eat away at the major source of consumer savings, the equity in the home."

Naturally, advertising is designed to sell products. The question is whether eye-catching ads encourage inappropriate financial behavior. No evidence has been proffered to suggest that advertising has produced any frivolous behavior with respect to actual uses of home equity lines. Further, no responsible lender condones misleading advertising. The recent Fed-Michigan survey indicates rational uses of the lines of credit by borrowers.

Consumers Are Sophisticated Borrowers

The consumers who enter into home equity transactions are sophisticated enough to understand the ramifications of the transactions They understand that the loan is secured by their home; they understand that variable rates mean variable terms and they understand the tax consequences

The American Banker newspaper reported in its May 12, 1987 edition that "consumer groups contended that many homeowners fail to understand the risks of home equity loans or to appreciate fully that they could lose their homes if they default on the loans." However, the consumer groups' press releases do not offer any support for this contention.

Even a casual reading of advertisements or the trade name of the products themselves, typically "home equity access account" or "home equity line", indicates that a home is involved. The TILA requires ample disclosures, discussed below, and provides for a three-day right of rescission.

Furthermore, the nature of the transaction with the need for appraisals, mortgage documents, and the like is similar to the consumers' initial mortgage application and closing process.

Recent data indicate that home equity line holders are sophisticated consumers. While AFSA research department data show that approximately 80% of traditional second mortgage borrowers have annual incomes of less than $36,000, the Fed-Michigan survey found that equity line holder's median education was 14 years with a median income of $40,000 and median home equity of $70,000 This appears to be hardly a group which would "fail to understand the risks of home equity lines", as the consumer groups contend

The Fed-Michigan survey respondents were asked whether enough information was provided by the lender at the time the account was opened. Over 90% of the line holders reported they had received all of the information they needed to make an informed decision.

Lenders Are In Business To Make Loans

Lenders have no desire to enter into transactions which lead to foreclosures. In fact, lenders will do everything possible to inform borrowers about the product in order to avoid any future problems. In deciding whether to grant such loans lenders evaluate the creditworthiness of the applicant whether that person has the willingness (shown by past credit history) and the ability (shown by income) to repay the

loan. A practical reality in the home equity lending business is that lenders have no desire to foreclose on a secured property. In most cases, foreclosure proceedings lose money for the lender.

Home equity lenders are in the lending business -- not the real estate business -- and are in business to make viable loans which a customer will renew.

Finally, if the borrower does encounter difficulty with meeting his obligations, responsible lenders will generally attempt to restructure the loan to avoid foreclosure.

Home Equity Lending Is Highly Regulated

Financial institutions' advertising and the offering of these products must comply with a myriad of state and federal laws For example, the following is a brief summary of applicable laws that a lender must consider before launching a home equity loan program

The TILA (and Regulation Z which implements the Act) applies to any consumer transaction secured by real property used or expected to be used as the consumer's principal dwelling

Two provisions directly relate to the initial disclosure statement required by Regulation Z. One requires that special disclosures be made for variable interest rate products. A lender offering a variable-rate product must disclose in the initial disclosure statement, circumstances under which the rates may increase, any limitation on the increase and the effects of the increase. The second provision permits the exclusion of certain closing costs from the finance charge (as in all real estate secured transactions).

Regulation Z governs home equity loan advertising. The open-end credit advertising rules provide that the use of certain terms trigger a requirement to disclose certain other key fees and charges that may be assessed in connection with a lender's credit program One term that triggers these additional disclosures is that which indicates that the lender would, in granting the loan, acquire a security interest in the borrower's home.

Perhaps the most dramatic TILA provision is the consumer's right to rescind the entire transaction within three business days. This applies when the credit plan is opened, when a security interest is increased to secure an existing plan, or the credit limit of the plan is increased.

The right to rescind exists for three business days following the last of three specified events These events include the occurrence which gives rise to the right of rescission, the delivery of the rescission notice required under the provision, or the delivery of all "material disclosures". If a lender fails to comply with these requirements, the borrower retains the right to rescind for a period of up to three years. A borrower may waive the right to rescind only in a bona fide personal financial emergency.

The Equal Credit Opportunity Act and Regulation B which implements the Act) also contains detailed rules about information that a lender can request from an applicant for a home equity loan.

Disclosures required under state law also generally apply to a federally-chartered or insured lender's home equity loan program unless the required disclosures conflict with federal law.

State disclosure requirements affect almost every phase of a home equity loan transaction. For example, at the application or preapplication stage, special disclosures

similar to the initial disclosures required by the Office of the Comptroller of the Currency's ARM regulation and the Federal Home Loan Bank Board's regulations may be required concerning the terms and conditions of the home equity loan.

Similarly, state "plain English laws may govern the transaction. Certain terms, such as a due-on-sale clause, may be required to be disclosed in particular documents to be effective. Further, advance notices may be required of adjustments in the interest rate on the account. Finally, disclosures peculiar to delinquent accounts may be required under state law, such as "right to cure" notices prior to the acceleration of any outstanding account balance and special disclosure requirements prior to the initiation of foreclosure proceedings. In addition to disclosure requirements, state laws may address fees and charges.

The marketplace -- through the operation of the secondary market -- exerts a disciplinary force on lenders by encouraging the standardization of documents and underwriting standards. Although the secondary market for equity loans is not yet fully developed, it has and will continue to have an increasing influence on lenders programs These standards provide an incentive to use prudence in all aspects of home equity lending. After all the bottom line for the secondary market is to ensure a minimal amount of loan defaults. Disciplinary forces exerted by the secondary market should not be discounted in determining the need for further regulation of this industry.

<u>No Data Support Additional Legislation</u>

Other than anecdotal citing of "horror cases", no major study has been undertaken to show the need for additional regulation. Many homeowners enjoy the benef ts of home equity products. No evidence has been advanced that further protective legislation is required.

As discussed earlier home equity lines of credit are a relatively new innovation available to consumers As such, evidence is just beginning to be assembled on the scope of the home equity lending business such as, how many financial institutions are offering the product how many consumers have utilized the product and to what extent have the ines been exercised. It was only in July of 1987 that the Federal Reserve Board began to collect separate data on the amount outstanding extended under home equity lines of credit by banks.

While efforts are continuing to collect and analyze as much data as possible, it may be too early to draw vast conclusions about any aspect of open-end home equity lines of credit

All available evidence suggests that consumers are pleased with home equity lines of credit and have not encountered any significant problems with them.

<u>H.R. 3011</u>

AFSA believes that this Committee should consider additional legislation only if such egis ation does not inhibit the positive growth of home equity lines of credit.

H.R. 3011, which addresses the disclosure requirements and advertising of home equity lines of credit, is a step toward achieving a balance between ful consumer awareness of this product and limiting the costs to lenders.

AFSA commends Representative Price and his staff for their willingness to meet industry representatives to discuss lenders' concerns regarding this important issue.

Our specific comments with respect to H.R. 3011 are as follows.

In section 2 of the bill, paragraph (1) of new subsection (c) requires that special home equity disclosures be given at the time of application, or in the case of telephone or mail applications, no later than three business days following receipt by the ender of an application.

This paragraph, however, also provides that these special home equity disclosures must be g ven "with the disclosures required by section 127(a)" (the disclosures required for open-end credit transactions under the current TILA). This could mean either of the following: (a) that the initial TILA disclosures must be given with the new home equity disclosures at the time of application, or (b) that the home equity disclosures must be given twice -- once at the time of application and once along with the initial TILA disclosure statement.

The first interpretation changes the timing requirements for the initial disclosure statement, which would disrupt settled practice. The second interpretation requires the home equity disclosures to be given twice. Currently, no other TILA disclosures must be given twice. Considering that these disclosures may already be required by other applicable law (discussed below), this approach is unnecessarily duplicative. Clarification is required.

The new disclosures also duplicate much that is required by the Federal Home Loan Bank Board's regulations which govern alternative mortgage transactions made by "housing creditors" under Title VIII of the Garn-St Germain Act of 1982. Many lenders offer home equity credit lines under the preemption provision of Title VIII and section 545 33 f) of the Federal Home Loan Bank Board's regulations which require detailed disclosures within three business days of the application. Subsections (f)(4)-(11) are applicable to housing creditors. (*See* the Appendix to 12 C.F.R. 545) This duplication should be eliminated by providing an exemption in the bill for creditors who comply with the early disclosure requirements of other federal agencies.

Subparagraph (F) of paragraph (3) of new subsection (c) requires the use of an example "based on a $10,000 amount outstanding". AFSA believes it would be confusing to know how to provide such an example because the periodic payment amount may vary depending on the appl cable interest rate in effect and whether or not any other advances have occurred

A more effective way to provide consumers with a meaningful example with similar information would be to require an example based on a $10 000 advance at the time the account is opened, and to show the minimum monthly payment amount that would be required to repay that advance at the interest rate in e fect at the time the account was opened, assuming no rate changes and no subsequent advances For transactions where the initial rate is an introductory rate which applies for a limited period of time, some adjustment should be made to reflect the normal index plus the margin rate after the discount period has ended. Rather than spec fying the parameters of the required example in the legislation, the mechanics should be left to the Federal Reserve Board

Subparagraph (F) of the bill also requires the disclosure of "annual percentage rates that were or would have been in effect under the plan at calendar year-end during the immediately preceding two years and their effect on the periodic payments under the plan stated as a dollar amount". Some home equity programs have an initial discounted rate feature for example, making the loan at the index rate itself, and then after a certain period of time a margin is added to that index rate to determine the effective interest rate It is unclear whether this requirement with respect to the preceding two years would be based on the initial rate or the rate which may be in effect later on based on a margin.

The prohibition of the phrase "loan at prime" needs clarification. Many home equity lines are based on the prime rate published in newspapers such as the Money Rate Section of The Wall Street Journal. We would want to be certain that the prohibition of the phrase "loan at prime" is intended to specifically prohibit that specific expression and not any use of the word "prime", or use of the prime rate as an index.

Subsections (c)(3)(E) and (c)(3)(F) contain references to adjustable rate plans without a maximum rate. These references appear to be no longer necessary because of the ARM interest rate cap requirement contained in section 1204 of P.L. 100-86, the Competitive Equality Banking Act of 1987. The Federal Reserve Board is presently seeking to amend Regulation Z to implement this provision. Accordingly, references to plans without a maximum rate should be deleted from the bill.

Conclusion

AFSA is willing to work with your Committee in addressing these concerns. Thank you, Mr. Chairman and Members of the Committee, for this opportunity to express our views.

Statement of the
American Bankers Association
on the
Home Equity Loan Consumer Protection Act of 1987
H.R.3011
Subcommittee on Consumer Affairs and Coinage
Committee on Banking, Finance and Urban Affairs
United States House of Representatives

October 6, 1987

Appendix I

Articles based on AFSA's "Consumer Finance Bulletin," which provided guidelines for consumers on home equity loans, appeared in the following newspapers:

Feb 4 1987	Press Democrat, Santa Rosa, CA
Feb 5 1987	Asheville Times, Asheville, NC
Feb 5 1987	Centralia Evening Sentinel, Centralia, IL
Feb 5 1987	Norman Transcript, Norman, OK
Feb 5 1987	Truth, Elkhart, IN
Feb 6 1987	Burlington County Times, Willingboro, NJ
Feb 6 1987	Carroll County Times, Westminster, MD
Feb 6 1987	Newburyport News, Newburyport, MA
Feb 6 1987	News, Harrisburg, PA
Feb 6 1987	News-Sentinel, Ft. Wayne, IN
Feb 6 1987	Oregonian, Portland, OR
Feb 8 1987	Courier Times, Levittown, PA
Feb 8 1987	Herald-News, Joliet, IL
Feb 8 1987	News-Press Santa Barbara, CA
Feb 8 1987	Northwestern, Oshkosh, WI
Feb 8 1987	Pensacola News-Journal, Pensacola, FL
Feb 8 1987	Review-Journal, Las Vegas, NV
Feb 8 1987	Sun-Times, Chicago, IL
Feb 8 1987	Sunday Record, Troy, NY
Feb 9 1987	Appeal-Democrat, Marysville, CA
Feb 9 1987	Arizona Republic, Phoenix, AZ
Feb 9 1987	Republic, Phoenix, AZ
Feb 9 1987	Star-Progress, LA Habra, CA
Feb 9 1987	The Record, Hackensack, NJ
Feb 10 1987	Daily Astorian, Astoria, OR
Feb 10 1987	Journal-Standard, Freeport, IL
Feb 10 1987	Tribune, Wisconsin Rapids, WI
Feb 11 1987	Stuart News, Stuart, FL
Feb 12 1987	Lawrence Eagle-Tribune, Lawrence, MA
Feb 15 1987	Cincinnati Enquirer, Cincinnati, OH
Feb 15 1987	Enquirer, Battle Creek, MI
Feb 15 1987	Kentucky Enquirer, Cincinnati, OH
Feb 15 1987	News-Enterprise, Elizabethtown, KY
Feb 15 1987	Orlando Sentinel, Orlando, FL
Feb 15 1987	Palm Beach Post, West Palm Beach, FL
Feb 15 1987	Times-News, Erie, PA
Feb 16 1987	Chattanooga Times, Chattanooga, TN
Feb 16 1987	York Daily Record, York, PA
Feb 19 1987	Gloucester County Times, Woodbury, NJ
Feb 21 1987	Cecil Whig, Elkton, MD
Feb 21 1987	Star-Free Press, Ventura, CA
Feb 23 1987	Palm Beach Post, West Palm Beach, FL
Feb 22 1987	Daily News, Camarillo, CA
Feb 22 1987	Tribune News, Whittier, CA
Mar 8 1987	Johnson City Press, Johnson City, TN
Mar 15 1987	Los Angeles Times, Los Angeles, CA
May 24 1987	Chicago Tribune [News Line] Chicago, IL
May 24 1987	Miami Herald, Miami, FL
May 24 1987	Sunday Record, Hackensack, NJ
May 24 1987	The Sun, Baltimore, MD
May 31 1987	Oklahoman, Oklahoma City, OK
Jul 2 1987	Post-Gazette, Pittsburgh, PA
Aug 8 1987	Virginian-Pilot Ledger-Star, Norfolk, VA
Aug 10 1987	Asbury Park Press, Asbury Park, NJ
Aug 28 1987	Sun-Times, Chicago, ILL
Sep 12 1987	Post Standard, Syracuse, NY
Sep 13 1987	Durham Morning Herald, Durham, NC
Sep 15 1987	Charleston Daily Mail, Charleston, WV

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October 6, 1987

Mr. Chairman and members of the Subcommittee, I am William T. Kirkpatrick, Vice President of Citizens and Southern National Bank in Atlanta, Georgia. I am also a member of the Consumer Credit Division Executive Committee of the American Bankers Association and a member of the faculty of the ABA's National School of Real Estate Finance and the National Consumer Credit School where I teach courses on home equity lines of credit.

The American Bankers Association is the professional and trade association for the commercial banking industry. The combined assets of our members represent approximately 95 percent of the industry total. We welcome the opportunity to present the Association's views on H.R.3011, the Home Equity Loan Consumer Protection Act of 1987.

The American Bankers Association supports the intent of H.R.3011 in its efforts to provide simple and understandable disclosure of loan terms to potential customers and to advertise home equity loan products in a responsible manner. However, in order to achieve our mutual goals, we offer some suggestions for modification to the proposed legislation.

Before I outline these suggestions, it's important to understand the recent developments surrounding the growth of this product, namely how home equity loans work, why they have become so popular with consumers and borrowers, and how lenders evaluate a consumer's creditworthiness

A home equity loan is really a derivation of the traditional second mortgage. Many of us remember the traditional second mortgage -- which was and still is a fixed-rate fully amortizing loan where borrowers received the full amount of the loan following approval. Payments were made in monthly installments usually over 15 or 20 years.

Today, the newest and most common kind of home equity loan is the home equity line of credit When we talk about home equity loans we are generally referring to a revolving credit line in which a consumer can borrow and repay against the line of credit as needed for a specific revolving credit period which may range from five to ten years. During this period the borrower may choose to pay a portion of the principal plus interest, or interest charges only The interest rate is generally an adjustable one which is indexed to a short term market rate like the prime rate and is subject to increase and decrease regularly as the index rate changes. Rates are typically lower than other consumer loans.

Following the revolving credit period of a home equity loan, any outstanding balance generally converts to a 15 year or 20 year amortizing loan at a fixed rate. However, some lenders may require a balloon payment where the balance is due at the end of the revolving period in one lump sum. Depending on the market, this balloon payment is often a customer driven feature.

Like any mortgage loan, there can be application fees plus any combination of appraisal, title, insurance, attorney, recordation and similar fees depending on the lender and location.

Why do consumers and lenders like home equity loans? Consumers like them for convenience and economics. Home equity loans provide a convenient way to access substantial amounts of credit at relatively low rates. Knowledgeable consumers prefer to have the ability to accommodate most of their lending needs on their own thereby avoiding repeated visits to the bank In addition, recent changes in tax legislation make these loans particularly attractive, because while interest deductibility is being phased out for most other forms of consumer credit, home equity loans <u>may</u> remain a source of tax-deductible credit for many consumers

Banks and other lenders like home equity loans because they are a secured and relatively simple form of credit. They provide good security for a bank, if managed prudently. Their lower cost in relation to loan size is reflected in the attractive pricing to consumers.

Let me underscore the importance of prudence. The home equity loan is an excellent financial tool for some consumers when offered properly and prudently by lenders and used properly by borrowers. If either fails to recognize the purpose for which it is intended, the risks associated with easy access rate volatility, and lack of payment discipline, can result in credit abuse and, perhaps in some extreme cases, the loss of the home.

Bankers and other traditional and regulated financial institutions have years of lending experience and generally adhere to prudent loan underwriting practices. Bankers base loan approval on the consumer's ability to repay. In other words, it is not based on equity alone, but on the consumer's total financial strength. Evaluation of each applicant's creditworthiness is done on a case-by-case basis The most important guideline in measuring the ability to pay is the <u>monthly-debt-to-income ratio</u> which relates to monthly gross income the monthly payment required to amortize the full home equity line of credit along with any other fixed monthly payments. The ratio can range between 30 to 40 percent, but can vary based on other borrower circumstances.

The other major credit determinant is the combined <u>loan-to-value ratio</u> or the ratio of all debt first mortgage plus the equity lines as a percent of the appraised value of the home). Combined loan to value ratios generally range from 70 to 80 percent and provide the cushion against a decline in the value of the home should the lender have to look to the home to repay the loan. The home, however, should <u>NEVER</u> be looked on as the primary source of repayment.

I cannot emphasize enough that reputable bankers and other traditional lenders are in the lending business, not in the foreclosure business. It is in our best interest to use the most prudent lending practices possible.

A recent ABA survey shows that banks are using conservative criteria for home equity lending. According to the ABA s 1987 Retail Bank Credit Report regardless of size, banks commonly reported a loan to value ratio between 75 to 78 percent for both fixed and variable rate loans well within the standard guideline of 80 percent. The report also found "most banks recognize that questionable advertising might confuse consumers " The survey indicated that the banking industry is already demonstrating a strong commitment to responsible advertising practices.

While we have heard a lot about the sudden growth of home equity loans, the simple fact is that second mortgages in general have been growing in popularity since 1980. According to the National Second Mortgage Association, second mortgage outstandings have grown from $34 billion in 1980 to $175 billion in 1986, and $35 billion of that was in home equity loans.

Like all credit instruments, home equity loans carry a potential risk. But the risks associated with them can be easily managed by responsible lenders and informed borrowers. Because of this belief the ABA has pioneered the public awareness efforts among the financial services industry. Last Fall concerned that some lenders were not advertising the product in the most responsible manner, the ABA formed a home equity task force to educate lenders. I chaired that task force and in December, 1986 the task force produced a "Home Equity Alert Kit." It offers guidelines for responsible home equity advertising which we feel the entire lending industry, not just banks should adopt We distributed thousands of these kits to bankers and to anyone else who requested them, free of charge, because of our commitment to responsible advertising.

In conjunction with this lender education effort, the ABA also compiled a comprehensive 700-page guide, "The Home Equity Lending Manual" for bank officers. This publication helps bankers design responsible home equity loan programs.

A next phase of the ABA's public awareness campaign was to produce a consumer brochure, "What You Should Know About Home Equity Loans " It gives consumers tips on both the benefits, and most importantly, on the potential pitfalls of these loans and it has been widely recognized for its candor. To date, more than 100,000 brochures have been distributed to the public.

This awareness effort was followed by a video press release designed to educate consumers and the media on the responsible use of home equity loans. Featured in the video tape are Mark W Olson current national president of the ABA who is also president of Security State Bank in Minnesota and Alexandra Armstrong, president of a renowned financial planning firm. The video was recently transmitted by satellite to more

than 700 TV stations covering every major market in the country and to date we know that at least 100 TV stations covering every major market in the country have already used the video in their news programs.

We will be happy to make these materials available for Subcommittee review.

In effect, much of what Congress is considering to require by law, our members have been doing on a voluntary basis and will continue to do so.

Nevertheless, we support reasonable disclosures of pertinent features of home equity financing products. These disclosures, however, should be meaningful, easily understood, and useful for the purposes of evaluating home equity products. We welcome Representative David Price's efforts to draft legislation to address this issue in a realistic way and we would like to make some recommendations to help streamline the legislation and improve consumer education on the responsible use of these banking products.

Subsection 2(c)(1) of the bill states that disclosures shall be given at the time of application for those who walk into the financial institution or in the case of telephone or mail applications "no later than three business days following receipt by the creditor of an application."

We are concerned with the wording of subsection 2(c)(1) for a number of reasons First the use of the word "given" could be construed to mean at the time received." It would be particularly difficult to comply with this subsection if the initial contact was made by telephone.

Second, this subsection requires that disclosures be given at the time of application for those who walk into the financial institution In those situations where the application is made by telephone or mail, the disclosures are to be provided "no later than three business days following receipt by the creditor of an application "

We believe it should be amended uniformly granting three business days in which to provide appropriate disclosure information. Regulation Z and the Real Estate Procedures Act (RESPA) afford three business days for various aspects of their regulations The Right of Rescission utilizes a three business day period and RESPA disclosure requirements provide for three days for disseminating information. The consistency of affording three business days for home equity information would provide regulatory uniformity and help bank officers avoid making errors which result from one critical variation in disclosure timetables.

Furthermore, subsection 2(c)(1) should be amended to indicate the lender's responsibility to mail the information within three business days. As the bill is currently drafted, one might construe that banks are required to see that the individual receives the information within three days. Once the disclosures are put in the mail, there is simply no way to control when they reach the consumer.

In addition, to prevent customers from arguing that they made an application when they only partially completed one (and the creditor does not believe the application is completed), we suggest amending the language to require applications be

written, and providing some elaboration concerning the type of application which will trigger disclosure.

With these concerns in mind, Subcommittee members may want to use the standard set forth in the current wording of the Truth-in-Lending Act section 128(b)(2) as a basis for drafting clarifications This section states that the disclosures "... shall be delivered or placed in the mail no later than the three business days after the creditor receives the written application...."

Subsection 2(C) requires disclosures of "Any fee imposed for the availability of the account including but not limited to annual fees, application fees, and the fees commonly designated as 'points'." If the specific fee information is not available at the time of application, disclosure problems might result We suggest amending this subsection to take into consideration the potential compliance problem by permitting as an alternative, "an explanation of how the charges will be determined " The revision would be similar to the wording currently found in the Truth-in-Lending Act, sections 226.6(a)(4) and 226.6(b).

The general wording of this subsection also creates a potential problem of how to disclose some fees which will be uncertain for a period of time such as appraisal fees and title insurance fees. We suggest that the Subcommittee amend the language to grant financial institutions flexibility under such circumstances to disclose initially that there are certain additional categories of fees whose exact amounts must be determined and later permit them to disclose the exact figures within a reasonable amount of time beyond the initial disclosure period.

Subsection 2(c)(3)(F) requires banks to provide an example based on a $10 000 outstanding loan. The example would include the periodic payments required under the loan and the annual percentage rates that would have been or were in effect under the plan for the immediate preceding two years, and the resulting payments. Assuredly some type of example would be helpful to consumers, and we support this concept as long as it educates consumers and does not cause compliance problems for banks. Rather than dealing with the specifics of the example in the legislation we suggest that the bill direct the Federal Reserve Board to have complete responsibility for drafting the appropriate example with the goals of consumer education and so eliminate compliance problems for lenders.

Some fine tuning of subsection 2(c)(3)(J) should also be undertaken to establish that in instances where there are interest-only payments, they may result in greater total expense over the life of the plan <u>than comparable plans that include payment of principal as well</u>. This additional phrase would clarify the point being made.

Subsection 147(d) states that the Federal Reserve Board has 180 days from enactment of the Act to prescribe regulations. Subsection 147(e) then indicates that the regulations will take effect at the end of the 180 day period. Such a tight schedule of the legislation can detract from efforts of the Board and the banks Haste in drafting regulations and in complying with new regulations increases the chances of errors and unnecessary expense The result would be confused and misinformed consumers. In the best interests of all involved, sufficient time should be provided for the Board to draft regulations properly and for banks to review and

implement the regulations without unnecessary risk of errors. We suggest that this subsection be amended to allow 180 days for compliance after the regulations have been finalized by the Federal Reserve Board.

Throughout the legislation moreover, the language should be amended to indicate it pertains to one's "principal" dwelling. Inasmuch as this bill would amend the Truth-in-Lending Act which covers among other types of lending those secured by one's principal dwelling, the amendment would standardize this bill so that it conforms to current law.

Finally, H.R.3011 should provide that federal law supercedes any state law relating to home equity financing products. Without this provision, states could create a patchwork quilt of related but inconsistent or different laws that ultimately could be to the disadvantage of the consumer and make disclosure compliance unduly complicated. Many financial institutions market home equity products regionally, and compliance with individual state laws would present unnecessary difficulties. We urge that H.R.3011 be amended so that federal law supercedes any state laws dealing with disclosures or advertising of home equity financing products.

In conclusion, I want to stress again the mutual concern of the American Bankers Association with the Congress in protecting consumers from the loss of their most important possessions -- their homes. We believe that home equity financing products must be used wisely and carefully and we are committed to seeing that happens.

We appreciate having the opportunity to testify on H.R.3011 and look forward to our continued work with members of the Subcommittee in developing a final version of this bill.

I will be happy to answer any questions that Subcommittee members may have.

HOW TO SHOP FOR A HOME EQUITY LOAN

A CHECK LIST OF QUESTIONS YOU SHOULD ASK LENDERS:

- Is there an introductory interest or "teaser" rate on the loan?
- If so, how long will the introductory rate last?
- What is the annual percentage rate?
- How is the rate established?
- How often will the rate change?
- How much money will the bank lend me?
- Does the variable-rate home equity loan have an interest ceiling or "cap" to protect me if the rates go up?
- Is there a limit or "floor" as to how low the rate may decline?
- What kinds of up-front costs must pay for the loan?
- Is there an annual other fee(s) associated with the loan?
- What the repayment terms and options?
- Will be faced with lump-sum "balloon" payment where the entire balance of my loan is suddenly due in one payment?
- Once the loan agreement is signed, are any terms subject to change?
- What is the length of the loan?
- How do access the funds in my loan?
- What are the minimum withdrawal requirements?
- Is there conversion clause in my agreement that will allow me to change from a variable to a fixed-rate loan?

A HOME EQUITY LOAN IS AN IMPORTANT YET COMPLEX FINANCIAL TOOL. TAKE TIME TO SHOP CAREFULLY. TALK TO YOUR LOCAL BANKER TO DETERMINE IF A HOME EQUITY LOAN IS RIGHT FOR YOU.

A service of the American Bankers Association

AMERICAN BANKERS ASSOCIATION

EQUAL HOUSING OPPORTUNITY

AN OLD CONCEPT, A NEW IDEA

Many consumers remember the traditional second mortgage—a fixed-rate fully amortizing loan where borrowers, upon loan approval, received the full amount of the loan and paid it back in monthly installments usually over 15 or 20 years. The home equity loan is really a derivation of the traditional second mortgage and it comes in two varieties.

TWO KINDS . . .

The newest and most common kind of home equity loan is the **home equity line of credit**. This is a revolving credit line where a consumer can borrow and repay against the line of credit as desired for a specified revolving credit period which may range from five to 10 years. During this period the borrower pays interest only or a portion of the principal plus interest. The interest rate is an adjustable one which is indexed to a short-term market rate like the prime rate and is subject to increase and decrease regularly as the index rate changes. After the revolving credit period, the outstanding balance may convert to a fully amortizing loan which is repayable in monthly installments over a period that could range from 10 to 20 years. However, some lenders may require a "balloon payment" where the entire balance is due at the end of the revolving period.

The other kind of home equity loan is very similar to the traditional fixed-rate second mortgage and does not include a revolving credit feature. These loans which are known as **home equity installment loans**, may have either a fixed-rate or variable rate.

WHAT IS MY POTENTIAL LOAN AMOUNT?
You may be eligible for an equity loan up to 80 percent of the appraised value of your home less the balance on your first mortgage:

	example	your home
appraised market value of home:	$110,000	$____
x 80%:	x 80%	x 80%
	$[illegible]	$____
minus the balance of your first mortgage: –	$[illegible]	$____
potential home equity loan amount:	$[illegible]	$____

CAN I AFFORD IT?
Bankers will analyze your total financial strength before approving a home equity loan. Loan approval is based on a consumer's ability to repay. A standard debt-to-income ratio may be used as a very broad guideline to determine repayment ability. This ratio relates the monthly payment required to amortize the full loan amount (not the amount used) along with other fixed monthly payments and compares it to monthly gross income.

AM I ELIGIBLE FOR A TAX DEDUCTION?
Consult your tax advisor to be sure. Generally, the following formula applies:

	example	your home
original purchase price of home:	$[illegible]	$____
plus substantiated improvements after purchase: +	$[illegible]	$____
total cost:	$[illegible]	$____
minus balance of 1st mortgage: –	$[illegible]	$____
Maximum deductible home equity loan:	$[illegible]	$____

HOME EQUITY LOANS ARE AN IMPORTANT FINANCIAL TOOL FOR CONSUMERS

THEY OFFER MANY BENEFITS

- **CONVENIENCE**—The revolving line feature and the higher credit limit on home equity loans gives consumers the ability to accommodate most of their lending needs on their own, thereby avoiding repeated visits to the bank. Money can be accessed with a check, coded telephone call or credit card.
- **COMPETITIVE RATES**—Home equity loans may offer borrowers more competitive rates than other consumer loans. This can be particularly true at the beginning of the loan term, when a low "introductory rate" may be in effect for a specified period. (But don't be mislead by introductory rate offers which usually apply for a temporary period.) Additionally, the variable-rate feature of home equity loans offers consumers a chance to get the best affordable interest rate in times of low market rates. Of course, consumers must keep in mind that payments may increase if market rates rise.
- **LIQUIDITY**—A house is a valuable, non-liquid asset. A home equity loan offers consumers a way to tap dormant equity by converting part of that built-up equity into personal cash flow.
- **TIME**—A home equity loan offers a longer repayment term than conventional consumer loans, which can be an added benefit for disciplined consumers.
- **TAX ADVANTAGES**—Some interest payments on home equity loans are still deductible, even though Congress will phase out other consumer loan interest deductions by 1991. Generally, interest is deductible up to the original purchase price of the home (not market value) plus substantiated improvements. The rules vary for educational and medical uses and for home loans financed before August 16, 1986. Ask your tax advisor if you're eligible for a deduction.

HOME EQUITY LOANS SHOULD NOT BE USED TO COVER CURRENT LIVING EXPENSES OR TO INCREASE YOUR STANDARD OF LIVING BEYOND YOUR MEANS.

Bankers recommend that these loans be used for **major** purposes such as home improvement, education, medical expenses, and prudent debt consolidation.

BUT KEEP IN MIND PITFALLS

- **DEBT OVERLOAD**—Can you take on additional debt? If you are a two income family, could you meet payments if one family member loses a job? Don't risk the equity in your home—make sure you borrow only what you need **and** what you can pay back in a reasonable time period. Remember, if you should have to sell your house because of a relocation or any other reason, it might not be wise to secure a loan with the equity in your home.
- **VARIABLE RATES WITH NO LIMITS**—Many home equity loans don't have limits on how high rates can go. Those who are uncomfortable with this potential risk may consider a fixed-rate loan or find a variable-rate equity loan that has an interest rate cap.
- **INTEREST-ONLY PAYMENTS**—Think twice about interest-only payments. They encourage perpetual debt and you may be faced with a large balloon payment at the end of the loan.
- **TEMPTATION TOWARD FRIVOLOUS SPENDING**—Home equity loans have been blamed for encouraging unnecessary spending, but ultimately it's the consumer's responsibility to exercise financial discipline. Generally, a home equity loan should not be used for current living expenses or for something that will depreciate in value over time.
- **AGGRESSIVE LENDERS**—Banks and other traditional lenders have years of prudent lending experience and are generally responsible loan providers. But beware of aggressive home equity loan marketing, especially from non-traditional lenders who may cut corners, skip thorough appraisals, provide only minimum information on loan terms, and make inappropriate loans.
- **FORECLOSURE RISK**—Remember, home equity loans are secured by a major asset—your home! If you are suddenly unable to meet loan payments, many bankers will help you devise an alternative payment schedule until you get back on sound financial ground. In the future, foreclosure is likely to be a feasible, but rare occurence.
- **CLOSING COSTS**—Like any other mortgage, a home equity loan has up front costs that may cover application processing, appraisals, title, insurance, attorneys and mortgage recording. Some equity loans also have annual fees.

The City of New York
Department of Consumer Affairs

80 Lafayette Street
New York, N.Y. 10013

Angelo J. Aponte
Commissioner

OCT 29 1987

October 27, 1987

The Honorable Frank Annunzio
Chairman
Subcommittee on Consumer Affairs and Coinage of the
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
Capitol Washington, D.C. 20515

RE: H.R. 3011

Dear Representative Annunzio:

I am writing to express to you and to the House Subcommittee on Consumer Affairs and Coinage New York City's position on the Home Equity Loan Bill (H.R. 3011) that is presently before you. We applaud your committee, Representative Price and his co-sponsors for taking timely and appropriate action to address the problems raised by the skyrocketing growth of home equity financing.

Because of new tax law provisions which became effective in January 1987, my Department anticipated that lenders would heavily promote home equity financing since interest payments on such loans remain tax deductible.

We started with the realization that consumers clearly take great risks when using home equity financing as a substitute for more traditional consumer loans. To most consumers their home is their only substantial asset. The decision to place it at risk requires careful deliberation of the financial and legal obligations involved and consumers must be encouraged to weigh the risks and costs of alternative financing before they pursue home equity financing.

Apparently recognizing the importance of fully informing consumers about home equity loans the American Bankers Association sent its members a "Home Equity Alert in March 1987 to emphasize to its members that bankers had a responsibility to encourage "educated and prudent behavior" by consumers, and that the industry had a responsibility "to ensure that consumers are offered clear accurate and meaningful information in home equity ads." (Copies of the "Alert" and Advertising Guidelines for home equity loans are attached as Enclosure 1.)

Because home equity financing affects such a significant consumer asset, my Department decided to monitor home equity loan advertising to see how fully and accurately financial institutions informed consumers about these loans. Thus, we surveyed home equity loan advertising that appeared in the major New York City metropolitan newspapers during a three month period in early 1987.

What we found was disheartening. Instead of the full and accurate disclosures recommended by the American Bankers Association, we found that the advertising of all twelve financial institutions we reviewed misled consumers. Our study led us to promulgate advertising guidelines about information to be included in ads so that consumers would not be misled.

The growth of home equity financing.

All types of home equity lending have risen astronomically in the last few years - from $34 billion in 1980 to over $200 billion in 1986 (a 488% increase in 6 years) And these numbers do not yet reflect the results of the heavy promotions we reviewed which sel home equity financing as a way to take advantage of the new tax laws Nor do we yet have any reliable statistics on how much home equity credit line financing, as opposed to more traditional second mortgage loans, has grown. Almost unknown six years ago, home equity credit line loans are now available from most f nancial institutions. The Federal Reserve Board has only recently begun to gather separate statistics on this financing activity.

The phenomenal increase in home equity financing has been fueled by the similarly explosive rise in real estate values, especially in metropolitan areas. There is over $4 trillion worth of unmortgaged home owners' equity waiting to be tapped. Equity financing has thus barely reached 5% of the potential market.

What are home equity loans?

Simply put, home equity loans (or lines of credit) are nothing more than loans using a borrower's home as collateral. A bank lends some percentage of the home owner's equity, usually 75 to 80%. The equity is figured as the current appraised value of a home less amounts still owed on existing mortgages. For example, a consumer whose home was appraised at $150,000 and who still owed $50,000 on an existing mortgage loan would qualify for a home equity loan for as much as $80,000 ($100,000 x 80%).

The key difference between a traditional second mortgage loan and its new-fangled offspring is the way borrowers tap the amount lent and how it is to be repaid. With traditional second mortgage financing, the borrower obtained the loan in a lump sum and paid interest on the entire loan amount. The borrower also repaid the loan according to a fully amortized fixed monthly payment schedule. The interest rate on the loan could either be fixed or variable.

The new home equity loans, on the other hand, are lines of credit allowing borrowers to draw on that line up to the maximum amount of the equity loan Borrowers can usually draw on that amount for a specified time period the "access phase." A borrower can use special checks or credit cards to draw on his or her credit line, and pays interest only on the amount borrowed, not the maximum loan amount. Depending on the

particulars of a lender's plan, there may be limits on the numbe of withdrawals within a specified time period and minimum amounts for each withdrawal

Credit line home equity plans do not require borrowers to repay the principal according to a fixed payment schedule, at least not during the access phase" of the loan. Payment terms vary greatly among lenders During the "access phase " borrowers usually must, at a minimum, make interest payments on the amounts borrowed. Some plans may require borrowers to make minimum monthly payments that could result in the repayment of some principal during the "access phase. Others do not. Borrowers can, however, repay the principal if they wish, and any principal repaid is then again available for future borrowing The loan's "access phase" typically lasts between 5 to 10 years, but the access phase" could remain open-ended so the plan would never actually require the bo rower to repay any principal. In that case the loan, in effect, either lasts until the home is sold, or lasts the borrower's lifetime and will not have to be repaid until the borrower's estate is is settled. Once the credit line terminates unde a plan, the borrower must begin to repay the principal. The repayment plan may call for one lump sum (a huge balloon payment), or may provide for a fixed payment schedule of anywhere from 15 to 20 years. The point at which the "access phase" terminates and repayment begins may be clearly specified in advance, (i.e. a specific number of years), or it may be left vague and terminate upon a lender's periodic review or upon demand by the lender. The particular payment terms of a plan can, however, combine various features.

The interest rate for home equity credit lines is almost always variable and tied to some index. The prime rate published in the Wall Street Journal is a frequently used index.

The new fangled equity credit lines touted by banks are, however, nothing more than the old-fashioned second mortgage in new clothes.

A new image for an old product.

Financial institutions have apparently found the way to shed the negative image second mortgages once had. That negative image was acquired during the Depression after thousands of home owners lost their homes when they were unable to repay second mortgage loans. And for more than five decades second mortgages were consigned to the fringes of financial respectability

The newly found popularity of home equity loans is evidence that lenders have successfully revamped the product to make it more acceptable to consumers. Unfortunately, merely spiffing up the image does nothing to eliminate the substantial risks consumers assume when they use equ ty financing.

Unless clearly and forcefully forewarned, consumers can easily overlook numerous traps in equity credit line loans,

especially if they rely on lender advertising that can lull them into a false sense of security. Here is how consumers can easily get hooked.

<u>The hidden traps in equity financing.</u>

1. Contrary to the image fostered by lender advertising, the only real way to unlock assets tied up in a home is to sell it. And once consumers do that, where are they to live?

The fact is that, except in unusual circumstances requiring careful planning (such as reverse annuity mortgages), equity loans are not meant to be repaid out of the equity tied up in the home, but out of a borrower's income. When borrowers rely on their incomes to repay a loan, there are very few purchases for which it is wise to use their homes as collateral. These may include college educations, home improvements that add to the value of the home, or unavoidable necessities like medical bills.

As our ad review showed, however, lenders are not promoting equity loans for such prudent purposes. Quite the contrary. Their advertising strongly encourages consumers to go on spending sprees with the cash freed from the home. The relatively low minimum withdrawal requirements, ranging from $100 to $1,000, are almost guaranteed to encourage profligate spending and overindebtedness.

2. The variable rates are usually uncapped for the life of the loan, a feature that shifts the entire risk of adverse rate fluctuations onto the borrower. An increase of only a few percentage points on a large equity loan can easily make payments unmanageable. For example, a mere three percentage point increase in the loan rate, from say 9% to 12%, would raise the payments on a $50,000, 20 year fully amortized loan from $449.87 to $550.55 (a 23% increase). On an interest only payment loan, the monthly interest costs would rise from about $375 to $500.00 (a 34% increase).

Although the Competitive Equality Banking Act of 1987 requires lenders to set a maximum rate on a loan in a residential mortgage transaction, this legislatively mandated maximum imposes illusory limits since lenders can set them as high as desired. Moreover, in the comments accompanying the Federal Reserve Board's Regulation Z amendments incorporating the new rate cap requirement, the Board indicated that lenders can terminate a revolving loan agreement when the rate cap is reached. Since the home equity credit lines are considered revolving credit, this interpretation makes the cap completely meaningless and potentially dangerous for home equity credit borrowers.

The relatively low default rate on these loans is no assurance of a safe future as lenders argue. Nor are we persuaded by lender arguments that these loans are safe and that lenders will follow prudent lending and forebearing foreclosure

policies. These loans are simply too new to say for sure what the delinquency rate will become when the loans and the borrowers have gone through several interest rate cycles And while lenders may mean well and not w sh to foreclose their present intentions will count or little when adverse rate fluctuations make the loans unmanageable for the borrowe . Just as banks are now foreclosing on thousands of farms despite all their best intentions when they originally made the loans to the farmers.

3. The variable rates are almost always tied to an unregulated and primar ly lender controlled index such as the "prime rate. This index is extremely sensitive to market fluctuations and using it practically guarantees that equity line oan rates will be volatile in a turbulent interest rate environment For example, the prime rate increased by over 6 percentage points during a three month period in 1980. That year, the prime rate changed 3 times changing five or more times in three different months that year. The prime rate actually exceeded the rates charged for other types of consumer loans during the early 1980 s. For example, from November 1980 to August 1981 the prime rate exceeded the rate for 48-month new car loans by up to 4.5 percentage points Tying uncapped variable equ ty credit lines to such a volatile index is an almost certain recipe for disaster if rates become as volatile as they were in 1980.

4. Low introductory teaser rates hide the true cost of the loan at the beginning of the "access phase" when consumers can still avoid overindebtedness. t's too late to learn about the true rates after a borrower has tapped his or he credit lines and now owes money. The promotions we reviewed focused on the artificially low introductory rates, and stressed the relatively low costs of home loans compared to other types of consumer credit. Statements like "loans at prime for two years or "Loans currently offered at 9 15%. That s 1.4% above prime for the life of the loan were commonly used to stress the low initial rate The ads were usually unclear about how long the rates would hold or what they would be after the teaser rate expired.

5. The present Truth in Lending Act (TILA) disclosure requirements are woefully inadequate for consumers searching for home equity credit line loans. The key problem not fully addressed by the proposed disclosures in H.R. 3011 is that equity credit line loans do not fit neatly into the distinct molds establ shed by TILA for open and closed-end credit That Act now treats open and closed-end cred t as completely separate and distinct types of financing, and sets different disclosure requirements for each.

Home equity credit line loans, however, combine features of both open and closed-end credit during different phases of the loan term. Requiring lenders to disclose only open or only closed-end loan terms fails to make consumers fully aware of their payment obligations and the cost of credit over the entire period of the credit line.

For example, open-end disclosure requirements presently do not mandate that lenders make clear at the outset whether the borrower may at some point be obligated to make a huge balloon payment. Such a payment must at least be iden ed fo closed-end loans, but it can now be hidden if home equity loan lenders are required to make only open-end credit disclosures.

6. The low or no principal repayment requ rements for these loans during the "access phase" substantially understates the real costs and debt servicing burdens consumers assume. By contrast raditional second mortgages with fully amortized, f xed payment terms al owed consumers to tell at the outset the full extent of their obligations.

7. Repayment terms may be so arranged that consumers can suddenly face huge bal oon payments. Consumers may, for example, be required to repay the entire outstanding balance at the end of the access phase;" the loan may have demand features enabling lenders to call the loan on short notice, or the lender may terminate the "access phase" and trigger repayment upon completing a pe odic "loan review."

Although lenders indicate they might refinance balloon payments, few are cont actually bound to do so. While lenders certainly might refinance such payments when economic conditions are favorable, what if conditions are unfavorable? Facing the loss of a home, consumers have ittle leverage to negotiate loan terms during unfavorable economic conditions.

8. The outstanding balance on home equity loans must be repaid in full along with any first mortgage balance) upon the sale of the home. This not so obvious and rarely disclosed requirement can become a substantial restraint on a family's subsequent housing options Having used up the equity in a home for ordinary consumer purchases, a family may suddenly find itself locked into its home.

9. Although the tax deductibility of interest payments has been touted n advert sements not all such interest payments are tax deductible under the new tax law. And the real value of the deduction depends on an individual borrower's tax situation. Determining the real tax benefits of a home equity loan requires individual financial analysis and tax planning.

The need for consumer protection legislation.

It is unrealistic to expect consumers to avoid the traps posed by home equity financing by depending on nothing more than their own knowledge and bargaining power.

The dramatic rise of home equity financing and the hidden dangers require more complete and accurate disclosures that identify key loan features, the risks, and the financial obligations consumers assume with home equity credit line loans.

Mere disclosures, however, are not enough to protect an asset as vital as a consumer's home. While marketplace competition can be expected to regulate lender behavior with respect to certain key and clearly obvious loan features such as interest rates and certain loan costs, it is absurd to expect consumers to negotiate with mega-banks about esoteric legal clauses like loan demand features and balloon refinancing obligations.

The fact is lenders do not compete on loan contract terms. Loan contracts are drafted by the lender, with blanks left for a few terms to be filled in later. As now practiced, drafting loan terms is a one-sided negotiation with the fine-print legal terms dictated by the lender.

Full and accurate disclosures must be backed by substantive protections governing loan terms that will minimize the risks of such loans.

Moreover, financial institutions have demonstrated that consumers cannot rely on self-regulation.

The American Bankers Association tried self-regulation when it sent its members a "Home Equity Alert" and issued advertising guidelines for equity loans The ABA sent the initial alert in March 1987, and the advertising guidelines followed soon after.

Judging from the advertising my Department reviewed, the alert and guidelines were almost uniformly ignored. The record, therefore creates no confidence that self-regulation in this area is anything more than a slogan to ward off real consumer protections.

There is no question federal action is the most effective way to address the problems involved. Financial transactions are less and less restrained by state boundaries. Jurisdictional lines between state and local and federal authority over financial institutions are murky. And consumers in each state should have the same minimum protections.

It is, therefore, both timely and appropriate for Congress to enact the kind of loan term dislosures and advertising requirements included in H.R. 3011.

While the bill is a solid beginning, we urge that its provisions be revised and supplemented to more fully address the problems and issues we have identified and to provide the additional protections consumers need.

A. <u>Disclosure requirements.</u>

We propose that the disclosure requirements for equity credit line loans be revised and strengthened as follows to

ensure that consumers are fully informed about both the closed and open-end credit features of such loans:

1. The content and timing of the initial disclosures for equity loans should be clarified. As it is, H.R. 3011 now requires that the additional equity disclosures "be given with" the initial disclosures now required for open-end credit plans. The bill, howeve would not require creditors to make the same disclosures that are currently required by TILA Section 127 (a) and Regulation Z. It also sets up a timetable for making equity disclosures that differs from the timetable that now applies to open-end credit plans.

The bill should establish a separate set of disclosure requirements for equity credit line loans and a separate disclosure timetable for the initial disclosures required for such credit plans. The initial disclosures should have to be made no later than the earlier of three days after a consumer submits a written application for an equity loan or before the lender receives any application fees or charges from a consumer.

2. The initial rate disclosures for equity credit lines should be the same as the requirements that now apply to open-end credit. Requiring the disclosure of only the annual percentage rate for equity loans, as H.R. 3011 does, will simply create confusion if lenders have to separately make other rate disclosures as now required by TILA.

The proposed option of allowing lenders merely to describe how the initial rate will be determined should be eliminated. Lenders should, instead, be required to state the specific rate that will be in effect when credit is first extended under the plan.

The proposed rate disclosures for home equity loans should be further strengthened by requiring that:

- lenders couple the APR and periodic rate disclosures with a description of the balances to which the rate(s) apply as TILA now requires for open-end credit.
- lenders disclose clearly any limitations that apply to teaser introductory rates, such as specifically stating the period during which the rate will be in effect, what the rate wi be when the teaser rate expires, and any restrictions on who qualifies for the teaser rate.

3. The proposed disclosure requirements for both the annual and lifetime loan rate increases should be revised to require lenders to disclose the maximum rate for the loan as provided by the Competitive Equality Banking Act of 1987. Lenders should also be required to disclose the minimum and maximum range reached within the last 1, 5, and 10 years by any index to which the loan rate is tied.

4. The proposed disclosure of periodic payment requirements for a sample loan amount (H.R. 3011 subdivision (3) (f)), is inadequate to inform consumers about the open and

closed-end payment features of equity loans. To ensure that lenders disclose both the open and closed-end payment features, H.R. 3011 should requi e the following.

Open-end phase payment term disclosures.

Lenders should be required to identify the loan access period, either as a specific time period or by a description of how it terminates, and any minimum payment requirements during the open-end phase of the plan. Lenders should be required to include the following open end payment features in the initial disclosure statement for home equity loans

• Examples showing the effect on the payment obligation if rates increased the maximum allowed under the plan during the f st year and for the lifetime of the loan. This requ red calculation could be based on the proposed $10,000 example or the maximum oan amount for which the consumer applies Alternatively the lender could be required to include information enabling a consumer to calculate the effect on the maximum requested loan amount based on the calculation for the $10,000 example.

• The numbe of payments that would be required to repay the sample or the actual loan amount according to the minimum open-end payment requirements, based on the initial and the maximum possible interest rate for the plan. If the minimum payment requirement calls for interest only payments, lenders should be required to state clearly and conspicuously that the balance will then never be repaid.

Open-end closing balance disclosures.

Lenders should be required to disclose the balance due at the end of the access phase if the consumer borrows the maximum applied for and makes only the minimum payments required by the plan.

Closed-end or final balance payment obligation disclosures.

Lenders must be required to describe the consumer's repayment obligation for any outstanding balance at the termination of the open-end phase of the plan. If the plan obligates the ender to extend financing for the repayment of the borrower's outstanding obligation, lenders should be required to identify the maximum repayment period the lender will allow, with a description of the payment schedule that would be required to repay the outstanding obligation based on the minimum payment requirements in effect during the open-end phase of the plan. The payment schedule should be computed based on the initial and maximum interest rate allowed under the plan. If the plan does not obligate the lender to extend financing for any balloon payment that could result under the terms of the plan lenders should be required to disclose clearly and conspicuously what the balloon payment could be, the borrower's repayment obligation, and consequences of

default.

<u>Periodic statement loan balance repayment schedule disclosures.</u>

Lenders should be required to disclose, in the periodic statements for open-end loans, information about the long-term financial obligations consumers assume as they draw on their equ ty credit line. The bill could provide that this requ rement is not triggered until the loan balance reaches some minimum amount like $5,000. Such additional disclosures should identify:

- the number of months it would take to repay the currently outstanding balance under the minimum payment terms in effect;
- the total amount of finance charges the consumer would pay in such case;
- what the consumer's final payment obligation would be at the termination of the "access phase" if the consumer made only the minimum payments.
- if applicable, the payment schedule needed to repay the final outstanding balance in accordance with the amortization period included in the plan, and based on the interest rate in effect as of the date of the statement.

5. The proposed disclosure of fees imposed for the availability of an account, (subdivision (3) (B) of the bill), should be revised to require that lenders segregate and separately identify one-time fees imposed for originating the loan, such as application fees and points, and recurring charges that will be imposed during the operation of the plan such as transaction charges or account maintenance fees Lenders should also be required to describe how recurring charges are incurred.

6. The proposed disclosure of the lender's security interest in the consumer's dwelling, (subdivision (3) (G) of the bill) should be expanded to require lenders to specifically identify what constitutes default entitling the lender to foreclose. This description should identify the specific circumstances that could allow a lender to demand repayment of amounts larger than the minimum payment requ rements included for the plan (other than default or late payment fees).

7. The requ rement that enders inform consumers that the disclosure of certain plan terms may be good faith estimates subdivision 3) (I) of the bill), should be coupled to a requirement that consumers be notified of any changes when the lende informs the consume that the oan is approved or when the consumer s ight to rescind the transaction under TILA is triggered, whichever occurs first.

8. The proposed requirement that lenders disclose their right to change any terms of an equity loan unnecessarily implies that lenders can freely change all contract obligations after consumers are almost irrevocably locked in. We strongly

urge that Congress delete this provision.

B. Substantive protections.

In addition to strengthening the disclosure requirements for equity loans we urge that substant ve protections be added to the bill to reduce the risks consumers assume with home equity financing. We therefore urge that Congress

• Establish a maximum amount for annual and lifetime rate increases The maximum annual inc ease should not exceed 2 percentage points above the intial rate, and the fetime increase should not exceed 6 percentage points above the initial rate Such limits would accomodate reasonable increases in payment obligations. Any greater increases simply lay the goundwork for disaster.

• Designate the indices lenders can use for determining rate changes so as to prevent lende s from selecting overly volatile indices or ones lenders can influence.

• Limit how frequently lenders can change rates on home equity loans, for example no more than once every three months. Require the lender to select the index rate in effect as of the same point in time within the time interval for changing rates (such as, for example, the first week-day of each three month period At a minimum lenders should be requ red to give a 30 day advance written notice before a rate change becomes effective. It is unacceptable to allow lenders to change rates as often as they ike and make it virtually impossible for consumers to anticipate their payments for sizeable financial obligations.

• Require that if an equity loan plan results in a consumer having to repay an outstanding balance greater than, say, five times the minimum payments required under the plan, the lender should then have the option of either refinancing the outstanding balance on monthly payment terms that are not greater than, say, 15% higher than the minimum payments required by the plan or which result in repayment of the entire obligation within a period no longer then, say, 15 years (unless the consumer agrees to a faster repayment schedule when the lump sum obligation became due) or be treated as an unsecured creditor under the bankruptcy laws i the outstanding balance is not refinanced on terms specified by law.

• Permit lenders to retain loan origination fees or charges only after the consumer s rescission rights are triggered under TILA, and require the refund of any amount already rece ved by the lender within the time period provided in the rescission provisions of TILA. Alternatively, lenders could be required to disclose, before collecting any fees or charges, the specific criteria they will use to approve an application, and then to identify specifically how a rejected consumer failed to qualify under the disclosed criteria. Improper disclosures or erroneous

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rejections should subject the lender to the TILA civil penalties.

• Prohibit lenders from changing loan terms affecting the repayment of existing balances except for variation in the interest rates specifically agreed to and tied to an approved index.

• Prohibit lenders from using payment demand features that could allow them to call loans like demand negotiable instruments. Such demand features may be appropriate for corporate financing, but not consumer home equity loans.

The substantive protections described above would prevent lenders f om using loan features that are most likely to impose unmanageable financial burdens on consumers and precipitate large scale defaults should the economy go awry.

C. Advertising requirements.

In add tion to the disclosure provisions and substantive requirements encompassed in H.R. 3011 or suggested herein, our review of home equity loan advertising in the New York City metropolitan area demonstrates the need for the advertising requirements included in the bill.

The nature of the violations reveals the failure to disclose key loan terms and limitations in ways that could significantly mislead consumers Our Home Equity Loan Report which more fully describes the results of our advertising review is attached as Enclosure 2.)

For example, only two of the 12 banks even mentioned that their loan offers involved a mortgage on the consumer s home. If they were disclosed at all, fees and other loan costs (often approaching $1,000) were listed in such fine print that it's a wonder anyone could read them. And while the ads pitched the tax advantages of these loans, they failed to alert consumers of the tax law's restrictions that could prevent all loans from qualifying for favorable tax treatment (Copies of some of the advertising we reviewed are attached as Enclosure 3.)

The ads uniformly stressed how easy it was to unlock the cash tied up in a home for anything you want, any time you want. They went overboard to encourage consumers to risk their homes for nonessential and even profligate spending like dream vacations.

Rather than encouraging prudent and educated behavior as the American Bankers Associat on recommended in their "Home Equity Alert," the financial institutions whose advertising we reviewed did the opposite And when conservative institutions like banks say it is okay to use you home this way, it is like telling consumers to throw caution to the wind.

The additional advertising disclosures and restrictions included in the bill would at least begin to alert consumers to

some of the less appealing features of this type of credit.

We do, however, encourage that the emphasis on full and accurate advertising disclosures be strenghthened by requiring lenders to include at least the following information about home equity loan terms when advertising includes the appropriate trigger terms:

- A statement that the loan is secured by a mortgage on the consumers home and that the consumer could lose the home by defaulting on the loan.

- The specific duration of any introductory, discount rate.

- The regular annual percentage rate and corresponding periodic rate that will apply after any introductory offer expires.

- The frequency of rate changes and maximum rate limits that apply to the plan.

- Any specific limitations on who qualifies for an introductory rate.

- The upper and lower limits reached within the last 2 and the last 10 years by any index used for setting the rate of a variable rate mortgage.

- The total of fees and charges a consumer may have to pay to obtain the loan.

Federal pre-emption issues.

Finally, we understand that the issue of expanding federal pre-emption of state advertising laws was raised at the hearings the committee held on this bill.

We strongly urge Congress not to change the federal pre-emption provision as now included in the Truth in Lending Act. The boundaries of federal and state ju isdiction as related to credit term disc osures and advertising are well-settled by the provisions originally enacted with TILA, and there is no compelling reason to change them.

The provisions of the Act were then considered to be, and should remain, a nationwide floor rather than the ceiling for protections consumers have in credit transactions.

If federal pre-emption of state laws is to be expanded, then it should be done only as part of an effort to enact a comprehensive federal consumer credit act that establishes national standards for substantive rights and disclosure requirements.

In closing, I cannot stress enough the importance of taking prompt and effective action to put in place the disclosure

AMERICAN BANKERS ASSOCIATION
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PRESIDENT-ELECT
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ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME

March, 1987

Dear Banker:

These are just some of the headlines appearing in recent articles on home equity loans:

> "Banks help you hock your home with home equity loans,"
>
> "Lenders put ticking time-bombs in your wallet,"
>
> "Home equity loans surrounded by a field of financial land mines..."

Such comments have been supported by a steady stream of advertisements which encourage consumers to:

> "Squeeze your home for cash,"
>
> "Borrow anything without asking,"
>
> "Realize that 30-year dream of cruising the South Pacific and pay for the WHOLE trip in 38 seconds," and
>
> "Turn your home into a giant credit card."

Home equity loans are an important financial tool of burgeoning interest to consumers and bankers alike. But questionable advertising and general confusion about the product may soon raise concerns among consumer activists, regulators and legislators on Capitol Hill.

What should the banking industry do? I'm contacting you first and foremost to say, "Be aware and be prepared." This issue has the propensity to become explosive overnight. No doubt you have already seen signs of confusion or misunderstanding reflected in the local press. Banks should prepare by establishing responsible lending criteria, adequate training activities for bank personnel and effective home equity communications to the public.

ENCLOSURE 1

AMERICAN BANKERS ASSOCIATION

HOME EQUITY ALERT AND

ADVERTISING GUIDELINES

AMERICAN
BANKERS
ASSOCIATION

1120 Connecticut Avenue, N.W.
Washington, D.C.
20036

PRESIDENT-ELECT
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ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME EQUITY ALERT * ABA HOME

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-2-

ABA TASK FORCE FORMED

ABA has formed a home equity task force to study this multifaceted issue. A first concern of the group is credible advertising. Because a home equity loan is secured by the borrower's house, we as bankers have a responsibility to encourage educated and prudent behavior. A step toward that goal is to ensure that consumers are offered clear, accurate and meaningful information in home equity loan ads.

AD GUIDELINES — FIRST FOCUS

We hope that you consult your counsel on the full implications of the Truth-In-Lending regulations that address credit advertisements. In addition, ABA has prepared some suggested guidelines on home equity advertisements. Take a close look at these guidelines and share them with your officers and marketing staff.

COMMUNICATIONS AND TRAINING — NEXT FOCUS

The home equity task force will also be developing guidelines for local media relations efforts. You can expect home equity loans to be a strong topic of interest in the press. When reporters start calling, it will be essential to direct all calls to designated spokespersons who are fully briefed on the subject. This task is not as easy as it sounds, since many of our own colleagues lack a full understanding of this product. The task force will also look at ways to encourage improved training efforts for bank personnel.

Home equity loans are sure to generate both enthusiasm and criticism in the coming months. It's a product that may make banks more vulnerable to the "slick-pitch carnival barker" image we have been hearing about recently. Home equity loans require careful training, consistent consumer education and strong media guidelines, and this is the first step toward more effective communication on this important issue.

Sincerely,

Charles H. Pistor Jr.

Charles H. Pistor, Jr.
President-Elect
American Bankers Association

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HOME EQUITY ALERT

HOME EQUITY LOANS: ABA COMMENTS ON ADVERTISING

Advertisements and other kinds of communication on home equity loans should be explained in clear and credible language. Banks should strive to present a standard base of information in advertisements so that consumers can determine which institution best meets their particular needs. A helpful rule of thumb for home equity loan ads is - when in doubt, explain.

FEDERAL ADVERTISING GUIDELINES

Before any advertising issues are addressed, banks should be fully knowledgeable about the federal regulations on open-ended credit advertisements. All home equity loan ads must comply with the requirements established by Regulation Z, Section 226.16 and related provisions. In brief, the regulation says that if an ad for credit states specific credit terms, it can only state those terms that actually are or will be arranged or offered by the creditor. The regulation does, however, allow a creditor to advertise credit terms that will be offered for a very limited time.

It is important to keep in mind that certain terms, if included in an ad, will trigger additional disclosure requirements. Trigger terms include finance and other charges that may be imposed under the plan. When trigger terms appear in ads, the ads must "clearly and conspicuously" set forth the following information:

- any minimum, fixed, transaction, activity or similar charge that could be imposed;

- any periodic rate that may be applied, expressed as an annual percentage rate; (If the plan provides for a variable rate, that must be disclosed.)

- any membership or participation fee that could be imposed.

Banks should consult their counsel for further details on these regulatory requirements.

TASK FORCE ADVERTISING SUGGESTIONS

Once banks have complied with regulatory obligations, the suggested copy points developed by the ABA Home Equity Task Force should be of further assistance. Home equity loan advertisements should include an adequate explanation of the following:

* Introductory variable rate of interest and the duration of special rate.

* Annual variable rate of interest and the time this rate is applicable.

* Index used to establish the annual variable rate of interest, for example, interest = prime + 2 percent; prime as published in the Wall Street Journal.

* Cap on the annual variable rate of interest, if applicable.

* Minimum balance and minimum draw requirements.

* Terms and frequencies of fees. (closing costs such as title examination, appraisal, points and/or origination fees, membership fees, transaction and maintenance fees).

* Minimum repayment terms; for example, interest only for five years, plus final lump-sum payment.

* If advertisements refer to the tax advantage of home equity loans, qualify the language as potential - not guaranteed - tax deduction. For example, home equity loan interest may be tax deductible. Do not position the bank as a tax expert. Ads should encourage consumers to consult tax advisors.

* Explain computation of equity in simple terms, for example, equity = 80 percent of (appraised value of home minus the outstanding balance of first mortgage).

DESIGN GUIDELINES

* Federal regulations for open-ended credit state that the size of type selected for advertisements should be clear and conspicuous. Credit terms are not required to be printed in certain type sizes or in any particular location in the advertisement. Credit terms, however, must appear in reasonably understandable form.

* Information on interest rates and fees should be presented with equal prominence. Consumers are suspicious of small type.

* Home equity advertisements should also include the Equal Housing Lender logo.

# # #

ABA CONTACTS:

Ed O'Connell, Manager, Retail Center

Mary-Liz Meany, Assistant Manager, Public Relations

ENCLOSURE 2

NEW YORK CITY CONSUMER AFFAIRS DEPARTMENT HOME EQUITY LOAN REPORT

The City of New York Department of Consumer Affairs

80 Lafayette Street
New York, N.Y 10013

Angelo J. Aponte
Commissioner

NEW YORK CITY DEPARTMENT OF CONSUMER AFFAIRS

HOME EQUITY LOAN REPORT

Tina Casey
Researcher
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Lois H. Tendler
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Patricia R. Kruger
General Counsel

Wilfredo Lopez
Investigator

Patric Morris
Investigator

I. BACKGROUND

Although home equity loans have been available to the public for a number of years, only in recent months has this form of consumer credit become the subject of vigorous promotion by banking institutions. Responding to this trend, the New York City Department of Consumer Affairs surveyed home equity loan advertisements from major New York City daily newspapers in March, April, and May 1987. The survey revealed that twelve different banks advertised home equity loans. After examining the advertisements and reviewing the applicable laws, the Department issued Notices of Violation pursuant to the Consumer Protection Law to each of the twelve banks for failure to clearly and conspicuously disclose material conditions on the offers advertised, or for ambiguously stating material facts.

A home equity loan is a form of home refinancing that establishes a revolving line of credit for a certain period of time, typically five to ten years. During this time the consumer accesses the account as desired by writing checks, generally for a minimum of $500. Unlike conventional refinancing, interest is paid not on the total loan amount but only on the amount withdrawn. Although some banks do not require any repayment of principle during this "access" period, the consumer may make voluntary repayments at any time without penalty, and these monies may be drawn again. At the end of the access period the consumer must pay the balance owed. Most plans surveyed provided for a ten to fifteen year repayment schedule though some required a single lump sum payment.

The sudden rise in the popularity of home equity loans over the past year derives partly from the new tax laws; after a four year phase-in period, home mortgages will be one of the few forms of consumer credit where interest payments will remain tax deductible. Consumers who desire to shelter some income could therefore consolidate other non-deductible installment debt by obtaining a home equity loan and drawing against it.

Home equity loans are also particularly attractive in the metropolitan area because of skyrocketing home values; as the amount of the loan is based on the appraised value of the property, many area homeowners may be eligible for loans far in excess of the amount they originally paid for their homes. However, the tax deductions are based on the original purchase price of the home plus improvements and not on its appraised value. For example, a borrower who paid $25,000 for a home 20 years ago and obtains a home equity loan of $100,000 based on a current appraisal will only be entitled to a tax deduction for the interest paid on withdrawals of up to $25,000. Only medical and educational expenses are exempt from this limit.

At first glance, the low introductory rates currently offered for home equity loans also make them appear to be good credit buys. Among the advertisements surveyed, banks offered introductory

rates as low as the prime rate, as published in the Wall Street Journal or New York Times, for as long as two years; in some cases, lower rates were available for shorter periods. As the prime rate is the benchmark rate for loans made to preferred corporate borrowers, it would appear that home equity loans are a good deal for consumers, who normally pay rates several percentage points higher than the prime rate. Some advertisements promoted home equity loans as a convenient and relatively inexpensive alternative to credit cards, the rates for which have recently been twice the prime rate or even higher.

Nevertheless, the pitfalls of a home equity loan are numerous. Although banks are promoting these loans with low introductory rates, the regular rate offered by each bank surveyed by the Department was an adjustable rate, capped only to the extent that it was pegged to a specified percentage higher than the prime rate. Among the banks surveyed, the regular rate ranged from 1.25% above prime to 2.5%. Consumers incur a high risk when borrowing at a rate pegged to the prime without annual or lifetime rate caps. Banks set the prime rate at their discretion; this rate is not subject to regulation. While the prime rate is currently 8%, as recently as 1981 it reached a high of 20.5%. It jumped to that level in just three years, from 8% in January 1978. Should a similar increase in the prime occur today, a typical home equity loan pegged 1.75% above prime would surge from 9.75% currently to 22.25% in just three years.

In addition, the introductory rates surveyed applied only to the monthly payments that would be made while that rate was in effect, not to the amount borrowed during that time. For example, if Jane Doe obtained a home equity loan of $100,000 with an introductory rate of 7.5% for the first year and immediately withdrew $25,000, only her first twelve payments on the $25,000 would be calculated at the rate of 7.5%. The rate of 7.5% would only apply to the entire $25,000 if Jane Doe repaid that sum before the end of the introductory period. Because this period typically commences when the loan is closed and not when the consumer begins to draw on the account, borrowers can easily pass up the benefits of the introductory rate if they delay drawing funds or if they make sparing use of their funds while the special rate is in effect.

In addition to unpredictable interest rates and elusive introductory rates, consumers may face potentially crippling balloon payments after the access phase of the loan. Under some plans, the borrower is required only to pay interest for part or all of the access period; once principle is added, monthly payments rise substantially. One bank in the survey offered an "interest-only" option under which the consumer must either make a single lump sum repayment after the access period or refinance the home for a second time at prevailing rates, incurring all costs associated with a new loan. Another bank provided for borrowers to access the account for as long as they live in their home; they would be required to pay principle as well as interest

during that time but must repay the balance owed in a single lump sum if they move. This sum would vary depending on whether the borrower made heavy use of the line of credit prior to moving.

Coupled with an increase in the prime rate, the onset of the payment period may pose a serious problem to some households. For example, a home equity loan is particularly risky and inappropriate for many households nearing retirement age, since by the end of the access period the household may be on a fixed income and may not have anticipated the impact of higher monthly payments on their budget. Banks have reported few foreclosures on homes refinanced through home equity loans, but with such loans coming into popularity only recently, it is too early to assess the risk to consumers by looking at current foreclosure patterns. Interest rates are still close to their lowest level since the early part of this decade, and most borrowers are still in the access phase of their loan, where their monthly payments may consist only of interest. In another five to ten years, many consumers who obtained a home equity loan this year will experience sharp increases in their monthly payments; rising interest rates at that time would most likely be accompanied by a rise in the rate of foreclosure. In the absence of a cap on consumer rates, a surge in the prime rate may overwhelm even the most competent planners. More importantly, with the "buy now, pay later" attitude of today, it may be foreseen that many households will manage their home equity loans unwisely and face burdensome monthly payments, or worse, after the access period "holiday" is over.

II. INDUSTRY GUIDELINES

Given these concerns, it is imperative that lenders advertise home equity loans in a responsible manner, targeting only those consumers who have the knowledge and discipline to manage a line of credit in their best interests. In its "Home Equity Alert" information kit, the Home Equity Task Force of the American Bankers Association (ABA) reminds ABA members that the relevant Federal regulations require "that the size of type selected for advertisements should be clear and conspicuous," further admonishing that "information on interest rates and fees should be presented with equal prominence." Nevertheless, these design guidelines were consistently violated in the advertisements surveyed by the Department. The advertisers also routinely ignored many of the Task Force's "Advertising Suggestions," which, among other points, advise that home equity loan advertisements adequately describe the duration of any introductory rate, any rate caps, minimum balance and draw requirements, fees, and repayment terms.

The Task Force explicitly warns ABA members that "[b]ecause a home equity loan is secured by the borrower's house, we as bankers have a responsibility to encourage educated and prudent behavior. A step toward that goal is to ensure that consumers are offered clear, accurate and meaningful information in home equity loan ads." This approach, too, was absent in many of the advertisements surveyed, a number of which contained phrases suggesting that consumers could use the home equity loan "any time you want, for any reason," or "for whatever you want, simply by writing a check," thus encouraging frivolous spending. Several advertisements specifically noted that the home equity loan could be spent on cars, exotic vacations, or the consolidation of other debts.

III. FEDERAL AND LOCAL LAW

The Truth-in-Lending Act (15 USC §1601 et seq.) and Federal Regulation Z (12 CFR 226) require that advertisers of consumer credit make certain specific disclosures if one of several "trigger terms" is used in the advertisement. These disclosures depend on whether the credit offered in the advertisement is "open-end" or "close-end."

A typical example of open-end credit, as defined in Regulation Z, is a credit card. The home equity loans offered in the advertisements surveyed are also open-end credit as defined in Secion 226.2(20). Each is offered under a plan in which the creditor contemplates repeated transactions, a finance charge is imposed on the outstanding balance and the amount of credit available is replenished to the extent that any outstanding balances are paid.

The applicable "trigger term" used in most of the home equity loan advertisements surveyed was the Annual Percentage Rate (APR). When the APR is used, the advertiser must also disclose "any periodic rate that may be applied expressed as an annual percentage rate...'f the plan provides for a variable periodic rate, that fact sh ll be disclosed" [Section 226.16, referring to Section 226.6]. ıerefore if an introductory APR is prominently tured in an adv rtisement, the advertiser must also disclose the APR that app ies after the introductory period expires. Regulation Z do s not specify the size or location of disclosures, but provides that the creditor "shall make the disclosures required by this subpart clearly and conspicuously..."[Subpart B, Open-End Credit, Section 226.17].

Regulation 204 of the New York City Consumer Protection Law requires that "[s]ellers offering consumer goods or services in print advertising must disclose clearly and conspicuously all material exclusions, reservations, limitations, modifications, or conditions." State law that is consistent with Regulation Z is not pre-empted [Section 226.28], and state law that provides greater consumer protection is considered to be consistent with Regulation Z ["Official Staff Commentry on Regulation Z," p. 104]. By failing to clearly and conspicuously disclose the APR that applied after the introductory period expired, and that the rate offered was variable, most of the advertisements surveyed by the Department were in violation of Consumer Protection Law Regulation 204. Additional violations consisted of the failure of some advertisers to disclose that the introductory rate applied not to the amount drawn during the introductory period but only to any payments made during that time; some also failed to disclose that the introductory period commenced at the closing of the loan.

By tying the Annual Percentage Rate to the prime rate, rather than making a positive disclosure that there was no cap on the rate offered, most of the advertisements also violated Consumer Protection Law 2203d-2.0(a)(2) which requires the disclosure of all material facts and forbids the use of ambiguity as to a material fact. Similarly, failure to disclose that the line of credit offered is secured by a mortgage violates this law. Additional violations by several of the advertisers consisted in their failure to disclose that the featured rate was offered only to current customers, or only to current customers that maintain two different types of accounts. Several advertisements also failed to disclose that higher rates applied to condominiums and co-operatives.

IV. ADVERTISING GUIDELINES FOR HOME EQUITY LOANS

A. LEGAL REQUIREMENTS

Any advertisement for a home equity loan that uses an Annual Percentage Rate must include the following:

1. Clear and conspicuous disclosure that the credit offered is a mortgage. For this purpose, use of the phrase "home equity loan" or "home equity line of credit" is insufficient.

   Sample Disclosure: "Your loan will be secured by a mortgage on your house."

2. If the featured APR is an introductory discount, the duration of the offer must be disclosed clearly and conspicuously For this purpose, an abstract reference such as "for one year is insufficient For example, if the introductory period commences when the loan is closed and applies to first twelve monthly payments (rather than to the amount the consumer draws during the first year), that fact must be disclosed.

   Sample Disclosure: "Prime Rate offered on any payments made up to one year after closing."

3. If the featured APR is an introductory discount, the regular rate that will apply after the discount expires must be disclosed clearly and conspicuously The regular rate must be disclosed both as to the specified percentage above prime rate that will apply, and as to the rate that would result under the current prime rate.

   Sample Disclosure: "Introductory rate of 8% guaranteed for any payments made up to one year after closing. After one year your rate will be 1.75% above the prime rate. Based on today's prime of 8%, this would result in a rate of 9.75%."

4. If the regular rate is pegged to the prime rate, there must be clear and conspicuous disclosure that the regular rate is variable and uncapped. For this purpose, naming the prime rate is insufficient.

   Sample Disclosure: "Your rate is variable and may increase without limit."

5. If the prime rate or any other rate pegged to the prime is offered as an introductory rate, there must be clear and conspicuous disclosure that the introductory offer

is also variable. For this purpose, naming the prime rate is insufficient

Sample Disclosure: "Bank X gives you the Prime Rate for any payments you make up to one year after closing. That's 8% currently...Your rate is subject to change during this special introductory offer."

6. If there are any material conditions pertaining to the featured offer, including but not limited to whether or not the borrower is a current customer or that a higher rate applies when the borrower's residence is a co-op or condominium, those facts must be disclosed clearly and conspicuously

Sample Disclosure: "Special rate of 1.5% over prime offered only to preferred customers."

Sample Disclosure: "This rate available only for 1-4 family residences...Ask about our rates for co-ops and condominiums."

7. Any advertisement that refers to a possible tax deduction must clearly and conspicuously disclose that the tax consequences of the loan will be different for each consumer and should instruct consumers to consult their tax advisor before applying for a home equity loan. In no case should tax benefits be promoted out of the context of the risk to consumers obtaining a home equity loan.

Sample Disclosure: "Your interest payments may or may not be deductible. You are advised to consult a professional tax advisor before you apply for a loan."

B. RECOMMENDATIONS

Given the potential for undisciplined or ill-advised use of a home equity line of credit, and given the financial risk incurred by consumers who refinance their homes through a home equity loan, advertising copy should avoid:

1. Promoting the home equity line of credit as a means of obtaining cash for specified or unspecified purchases, or for debt consolidation. It is particularly reprehensible to encourage consumers to risk losing their homes for the sake of non-essentials such as cars and vacations. Any reference to suggested uses for the home equity loan should be made in regard to planning or seeking financial advice.

2. Promoting the home equity line of credit as a means of obtaining cash quickly and conveniently. Because it is secured by the borrower's home, this type of open-end credit requires more consumer discipline and foresight than is required for the competent management of a credit card account. Any reference to convenience should make clear that the home equity line of credit poses this additional risk to consumers.

V. SUMMARY OF ADVERTISEMENTS SURVEYED

The New York City Department of Consumer Affairs surveyed major daily newspapers in March, April, and May 1987, and found twelve different banks advertising home equity loans. Each advertisement examined by the Department contained at least two features that violated the legal requirements set forth in Section IV of this report. The chart below refers to these legal requirements by number (1-7). The chart further notes whether a particular advertisement was in violation of Consumer Protection Law 20-700 and/or Regulation 204.

Table A. Summary of Violations for Each Advertisement
(Numbered Columns Refer to Legal Requirements, Section IV.A.)

BANK	CPL 20-700	REG. 204
Barclays Bank of New York	3,4,5,7	2,5,6
The Bank of New York	1,4	4,6,7
Chemical Bank	1,2,3,4,7	3,4,6
CitiBank North America	1,2,4,7	2,3,6
The Dime Savings Bank	3,4	1,2,3,4,5,6
Emigrant Savings Bank	1,4,7	3,6
The Empire of American Federal Savings	1,2,3,4,5,6,7	
First Federal Savings and Loan of Rochester	1,3,4,7	2,3
Long Island Savings Bank	1,4,5,7	4
Manufacturers Hanover Trust	1,2	
Marine Midland Bank	1,3,4,6,7	2,3,5
Williamsburg Savings Bank	1,2,3,4	4

As noted in the chart above, every advertiser except Barclays Bank of New York and The Dime Savings Bank failed to disclose clearly and conspicuously that the home equity line of credit is a mortgage.

In addition to violating these legal requirements, nine of the twelve advertisements failed to comply with banking industry guidelines as reviewed in Section II as well as with the recommendations of the Department as outlined in Section IV.B.

Examples of advertising copy that violated industry and Department recommendations are listed below:

The Bank of New York (New York Times, 4/23/87)

> "And you can write yourself a loan whenever you want, for whatever you want, simply by writing a check."

Chemical Bank (Daily News, 4/28/87)

"If you're looking for your cheapest source of money, check your house" (banner headline). "[Chemical's Home Equity Creditline] gives you access to a line of credit whenever you need it, simply by writing a check. It's that easy."

Citibank of North America (Newsday, 5/4/87)

"...you can keep up with expanding needs of your family. For example, the kids' education, home improvements, or anything else you want. It s easy to use and re-usable."

The Dime Savings Bank (newspaper supplement, 5/10/87)

"Turn your home equity into a credit line you can access with a free VISA Card ... A cash reserve for anything you want, whenever you want it ... For an exotic vacation. For a new car, for investments, for holiday bills...for any purpose under the sun."

Emigrant Savings Bank (New York Times, 3/12/87)

"Use your house power!" (banner headline). "Your credit line is good for ten years and you can use all or part of it just by writing a check."

The Empire of American Federal Savings (Newsday, 5/4/87)

"...you can use the equity in your home to make it your dream home. Or buy a vacation home, put in a built-in pool, you have it."

First Federal Savings and Loan of Rochester (New York Times, 4/14/87)

"First Equity is a revolving line of credit to use anytime for your personal, family, or household needs."

Long Island Savings Bank (New York Times, 3/11/87)

"You get a book of checks so you can write yourself a loan anytime you want, for any reason you want."

Williamsburg Savings Bank (New York Times, 3/12/87)

"Imagine being able to write a check for a new car, major home improvement, tuition, vacation, wedding, or to consolidate other debts."

ENCLOSURE 3

COPIES OF HOME EQUITY

LOAN ADVERTISEMENTS

Harry A. Blackmun, ... | ... as provided with the evidence supporting the employee's complaint. The case stems from the 198_ ... | Call ahead for your videotape appointment at the store nearest you.

With the new tax law, his is more than just a shelter for your family.

This year, nearly every taxpayer will be affected by the revised tax law.

However, if you're a homeowner, The Bank of New York can suggest two ways that allow you to deduct interest payments from your taxes.

ESTABLISH A HOME EQUITY CREDIT LINE WITH EQUITYLINK.™ Our home equity loan is currently fered at 9.15%* That's 1.4% above prime for the life of the loan—the lowest long-term rate, with no points, of any ajor bank. What's more, our low rate applies to both customers and non-customers.

EquityLink lets you establish a line of credit against the value of your home.** And you can write yourself a loan henever you want, for whatever you want, simply by writing a check. Better yet, with EquityLink, you may write part all interest off your taxes.

REFINANCE YOUR MORTGAGE AT A LOW FIXED RATE. You also have the option of refinancing your me with a mortgage that allows you to lock in today's low rate for the life of the loan.† What's ore, you can consolidate all your other loans under one large interest-deductible loan.

Finally, The Bank of New York makes sure that applying for either of these loans won't tax ur patience. Because we act promptly, instead of making you wait a long time for approval.

So consult your tax advisor. And call our ActionPhone at 1-800-942-1784 (out-of-state, call 14-684-5514 collect). Or stop by any of our branches. And we'll show you how to make a few significant improvements in your life, while you're making a few substantial deductions from your taxes.

THE BANK OF NEW YORK

NYT 4/23/87

IF YOU'RE LOOKING FOR YOUR CHEAPEST SOURCE OF MONEY, CHECK YOUR HOUSE.

You could be living in your cheapest source of money. Because now you can use the equity in your house or condominium to get a line of credit for whatever you need. Chemical's Home Equity Creditline (CHEC℠) lets you borrow for anything from your children's education or an addition on your house to debt consolidation and investments. And ChemPlus℠ customers pay only the prime rate* for the first year.

CHEMICAL'S HOME EQUITY CREDITLINE

7¾%

APR
NO POINTS

TAX BENEFITS

Plus your home can help you with your taxes. Because with a home equity credit line, your interest may be tax deductible under the new tax law. That's very important since few other sources of credit are.

ACCESSIBILITY AND CONVENIENCE

CHEC gives you access to a line of credit whenever you need it, simply by writing a check. It's that easy. And you get 10 years of credit with one application. Plus, there are no points to pay.

IT PAYS TO CHECK INTO CHEMPLUS

ChemPlus is your smartest choice for banking because it links all of your Chemical accounts together allowing you to take advantage of many special benefits, like being able to borrow at the prime rate for one full year.

So if you're looking around for money, there's no place like home. And there's no place like Chemical. You can call our hotline for more information about CHEC and our other Home Equity Loans. Fill in the coupon below and mail it to us. Or check into any of our 280 branches. There's probably one close to home.

CHEMPLUS
1-800-243-6226

Chemical Bank
300 Jericho Quadrangle
Jericho, NY 11753
Att: Home Equity Specialist

Name
Address
City State Zip
Business Phone Home Phone

CHEMICALBANK

All loans subject to credit approval. Rate shown above is for ChemPlus customers. Rates and terms subject to change without notice.

7.4%*

WE'VE LOWERED THE COST OF RAISING CASH.

The Citibank Equity Source Account™ now at a new lower rate.

For a limited time, you can get a new low introductory rate on a Citibank home equity loan. Apply by June 30th, and the special introductory variable rate is good for the first six months. You don't even have to be a Citibank customer to get it. And Citibank has no upper limit for a line of credit. There's lots more to like, too.

It can expand with the value of your home. Your line of credit can expand along with the growing equity in your house, co-op, or condo.* So you can keep up with the expanding needs of your family. For example, the kids' education, home improvements, or anything else you want.

Choose your own terms. After the first six months, you can pay either 1¾% above the Prime Rate and no points. Or 1¼% above the Prime with two points. We'll help you calculate which is best for you.

If your co-op is your castle... that's okay with us. Unlike some other banks who don't handle co-ops, Citibank offers our home equity line of credit on your kind of home—whether it's a co-op, a condo, or a house. And you don't have to pay a higher rate because your home is a co-op.

It's easy to use and re-usable. Apply once, and your line of credit is good for ten years, or possibly fifteen years. Simply write a check for $250 or more. And all you have to pay is interest during this time.*

It's the last great tax deduction. The new tax law makes the Citibank Expandable Equity Source Account just about the smartest way to borrow. Because the interest may be tax-deductible.

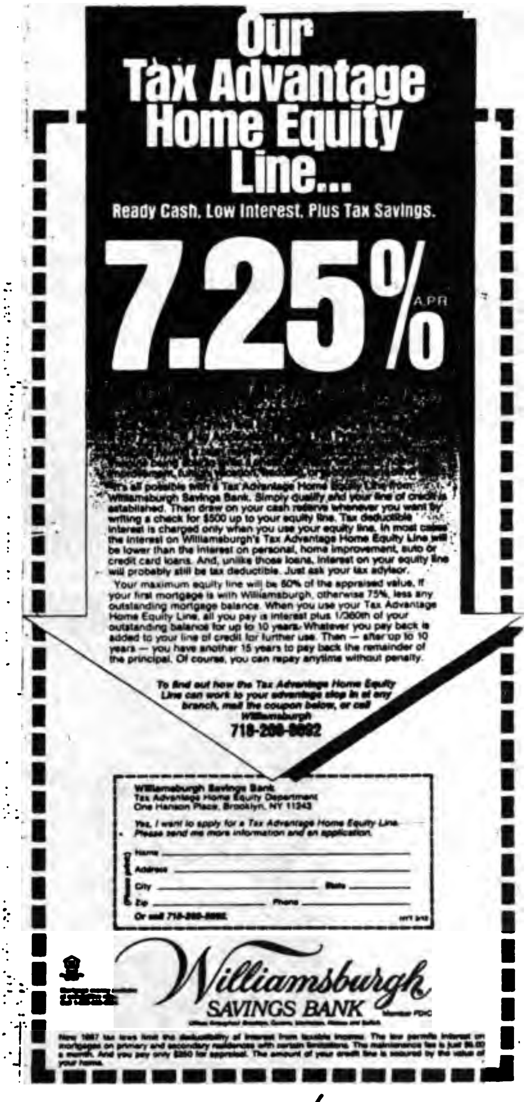
Just ask our Equity Source Account specialists for details at any Citibank branch. Or call **1-800-248-4472, ext. 2722.**

WE'RE THINKING WHAT YOU'RE THINKING™

CITIBANK®

A CITICORP COMPANY

28 NY NEWSDAY, THURSDAY, MAY 7, 1987


Our
Tax Advantage
Home Equity
Line...
Ready Cash. Low Interest. Plus Tax Savings.
7.25%
A.P.R.
It's all possible with a Tax Advantage Home Equity Line from Williamsburgh Savings Bank. Simply qualify and your line of credit is established. Then draw on your cash reserve whenever you want by writing a check for $500 up to your equity line. Tax deductible interest is charged only when you use your equity line. In most cases the interest on Williamsburgh's Tax Advantage Home Equity Line will be lower than the interest on personal, home improvement, auto or credit card loans. And, unlike those loans, interest on your equity line will probably still be tax deductible. Just ask your tax advisor.
Your maximum equity line will be 80% of the appraised value, if your first mortgage is with Williamsburgh, otherwise 75%, less any outstanding mortgage balance. When you use your Tax Advantage Home Equity Line, all you pay is interest plus 1/360th of your outstanding balance for up to 10 years. Whatever you pay back is added to your line of credit for further use. Then — after up to 10 years — you have another 15 years to pay back the remainder of the principal. Of course, you can repay anytime without penalty.
To find out how the Tax Advantage Home Equity Line can work to your advantage stop in at any branch, mail the coupon below, or call Williamsburgh
718-200-8892
Williamsburgh Savings Bank
Tax Advantage Home Equity Department
One Hanson Place, Brooklyn, NY 11243
Yes, I want to apply for a Tax Advantage Home Equity Line.
Please send me more information and an application.
Name
Address
City
State
Zip
Phone
Williamsburgh
SAVINGS BANK
Member FDIC

NYT 3/12/87